AN ANALYSIS OF SELECTED WORLD TRADE ORGANISATION AGREEMENTS TO DETERMINE WHETHER THEY DISCRIMINATE UNFAIRLY AGAINST DEVELOPING ECONOMIES.

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Abstract

The focus of this thesis is the question whether or not the WTO discriminates unfairly against developing economies. In the absence of a test of guidelines for determining unfairness or fairness of WTO provisions or Agreements has been drawn up using welfare economic and constitutional law principles as a foundation. Unfairness is therefore determined by asking whether the provisions of each Agreement are rational, proportional, efficient and whether they prevent the abuse of power amongst states. In addition, the economic effects of the provisions of the selected Agreements have been analysed to determine whether the relevant provisions are welfare enhancing and conclusive to promoting growth and development within developing economies. The Agreements chosed for analysis are the Agreements on Trade-related Investment Measures (TRIMS), Trade-related Intellectual Property (TRIPS), Agriculture and Services (GATS). The dispute settlement and negotiating process, labour standards and the impact of decreasing most-favoured nation rates on developing economy competitiveness is also discussed.

Application of the test has shown that the WTO provisions do not reflect the interests of all members. Even though most member states are developing economies, the3 Agreements constantly cater foe developed country concerns and interests. Where provision is made for developing country interests, it is the LDC's who are favoured, with normal developing economies being bound by the same provisions as the developed economies. A formal, as opposed to a substantive, definition has been adopted by the WTO, with a result that the process of equality is placed above the outcomes. While concessions have been made to development, members have not gone for enough. A main reason for the imbalance can be attributed to the negotiating process, which is based upon concessionary bargaining and trade-off. Those states with greater economic power are therefore at an advantage as they have the leverage needed to influence the outcomes of negotiations and hence the provisions of the various Agreements. Even with the

LDC's, the WTO has been found to discriminate unfairly against developing economies because it does not adequately address developing country concerns.

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Contents

Chapter 1

Introduction

1.1 The purpose of study

In a formal sense, the General Agreement on Tariffs and Trade (GATT) of 1947 was not an international organisation, that is, a legal entity in its own right, but rather an inter-governmental treaty. This changed on 1 January 1995 with the establishment of the World Trade Organisation (WTO), at the end of the Uruguay Round negotiations. As a result, participants were regarded as Member states, not the contracting parties.[1] The WTO[2] is an international organisation which administers multilateral agreements which relate to trade in goods (the GATT) or trade in services (the General Agreement on Trade in services GATS). At the heart of the WTO is the dispute settlement body which offers Member states a means of settling disputes which is unique in international agreements.[3] While the GATT 1947 was both a set of rules and an institution, the GATT 1994 is simply a set of rules that is part of the WTO.[4]

The GATT 1947 legal structure was plagued by its provisional status and significant ambiguities concerning the legal status of particular texts. The Uruguay Round texts and the WTO treaty have sought to improve on these matters.[5] The Uruguay Round negotiations were also a response to the managed trade and new protectionism that had arisen and grown during the late 1970s and the early

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1 Hoekman and Kostecki (2001:37). For clarity a distinction between previous GATT Agreements and GATT 1994 will be made by referring to the status of the parties prior to the WTO as Contracting Parties and after the WTO, as Member states.

2 For an in -depth study of the WTO, see Jackson (1998:36-58).

3 The Dispute Settlement Body (DSB) provides Member states with a means of settling disputes within the context of the WTO. More importantly, the DSB provides Members with a proper structure for settling disputes. For more on the DSB, see Jackson, op cit note 2 at 59-100.

4 Hoekman and Kostecki, op cit note 1 at 37.

5 Jackson, op cit note 2 at 36-37.

1980s.[6] During the Uruguay Round negotiations,[7] it was agreed that the negotiations were to be a single undertaking. When the creation of the WTO was proposed, the concept of a single undertaking was redefined to mean that all GATT contracting parties had to become WTO Members. States had no alternative, most developing countries therefore joined the WTO.[8]

While developing economies make up the majority of WTO Member states, there is great concern amongst these states that the WTO, through GATT and GATS, discriminates against their interests, with negotiations on rules reflecting the agenda of high income countries. There are also concerns that the rules adopted by Member states are not consistent with the development priorities of low income countries.[9]

The purpose of this thesis is to determine whether the WTO discriminates unfairly against developing economies. As a test for determining unfair discrimination within the WTO context does not exist, the drafting of such a test will constitute an important part of this thesis. The principles contained in this test will then be applied to selected WTO Agreements, to determine whether these agreements do in fact unfairly discriminate against developing economies. Analysis of the various WTO Agreements will be linked to an economic analysis of the welfare effects of their provisions on developing economies.

1.2 Scope of study

Agreements which are of particular importance to developing economies have been chosen as a focus. The study includes the provisions relating to decreasing tariff and non-tariff barriers and their

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6 Hoekman and Kostecki, op cit note 1 at 43.

7 These are multilateral GATT negotiations which occurred during the period 1988-1995.

8 Hoekman and Kostecki, op cit note 1 at 49.

9 Hoekman and Kostecki, op cit note 1 at 480-482.

effect on the Generalised System of Preferences,[10] agriculture, dispute settlement within the WTO, trade-related investment measures (TRIMs), trade-related intellectual property rights (TRIPS) and the General Agreement on Trade in Services (GATS). The study also includes a discussion on the merits of incorporating labour issues into the WTO framework.

Despite the diversity of the Agreements and issues being studied, they have not been chosen randomly. The Agreements on TRIMs, TRIPS and GATS are all linked to the issue of foreign direct investment (FDI). Give the general lack of capital which influences developing country performance, FDI is of particular importance to developing economies. Labour standards are also linked to the question of FDI determinants and are relevant to the question of development. The Agreement on Agriculture together with tariff rates is directly linked to market access provisions while the dispute settlement and negotiation procedures provide insights into the power balance amongst states and the extent to which the interests of developing countries are provided for. All these Agreements or WTO procedures are directly linked to the developmental aims of developing economies or the protection thereof. By focusing on these particular Agreements and provisions, it is possible to determine whether developing country interests are being unfairly discriminated against.

1.3 Sources and approach

The material used in this thesis was obtained mainly from the WTO and its Agreements as well as books and articles written on both the economic and policy aspects of the relevant Agreements. Much of the material included in this thesis is drawn directly from the various treaties. Since the motivation for the thesis was to determine whether the relevant GATT Agreements and the GATS contribute towards the economic growth and development prospects of developing economies, attention has been paid to the economic effects of the various Agreements on developing country economies. Because of the economic focus of the various Agreements, the welfare effects of the

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10 These are the preferences extended to developing economies by developed countries in deference to their particular growth and development needs.

provisions of these Agreements upon developing economies form an important component of the test for unfair discrimination. Within every discursive chapter, there will therefore be a dual focus. The welfare effects of the provisions of the relevant Agreement upon developing country growth will be discussed, where possible, and the test for unfair discrimination applied. While the economic analysis may appear to be unrelated to the test, it is an important component of this thesis, as it will show whether the GATT or GATS provisions achieve their economic goals.

1.4 Structure of the thesis

The thesis has been divided into an introduction, eight discursive chapters and a conclusion. The first discursive chapter focuses on determining a test for unfair discrimination. Because of the neoclassical foundation of the WTO Agreements, this chapter discusses the neoclassical, Pareto and utilitarian approaches to efficiency and a basic economic view of discrimination. Rawls's "theory of justice" is incorporated as part of the discussion on fairness and forms a bridge between the economic discussion of efficiency and the legal provisions on equality and unfair discrimination. The test for unfair discrimination is based upon both economic and legal principles.

The five chapters which follow question whether the present tariff system, a social clause, and the Agreements on Agriculture, TRIMs, TRIPS and GATS discriminate unfairly against developing economies. The objective of each chapter is to determine the welfare effects of the provisions of the respective Agreements and through application of the test for fairness determine whether the relevant WTO provisions enable the developed countries to discriminate unfairly against developing country interests. The chapters on dispute settlement and GATS do not contain an analysis of the welfare effects of the provisions because of the nature of these provisions. The main focus of these chapters is the question of fairness or unfairness. The thesis ends with concluding remarks.

Chapter 2

A theoretical model for determining unfair discrimination within the GATT context

2.1 Introduction

Recognition of the equality of all people has been one of the most groundbreaking developments of human rights jurisprudence. This principle, usually applicable to relations between and amongst people, has also been extended to states. Nonetheless, because of the many facets attached to the concept of equality, it has been extremely difficult to define. The concepts of equality accepted by states to govern their people generally reflect cultural development of the individual societies.[1] While most states subscribe to some form of recognition of the principle of equality, it often happens that within states some people or groups are more equal than others. This may occur when states adopt a formal rather than a substantive definition of equality. Formal equality simply requires that all persons are equal bearers of rights. According to this view, inequality can be eliminated by extending the same rights and entitlements to all in accordance with the same neutral norm or standard of measurement. Substantive equality requires an examination of the actual social or economic conditions of groups or individuals in order to determine whether the right to equality is actually being upheld.[2]

This chapter is about determining fairness. More specifically, its focus is on the determination of a test for unfair discrimination within the GATT context. Due to the economic and legal nature of the GATT document, it is necessary to determine fairness within both contexts. Discrimination within an economic context will be discussed, together with economic and jurisprudential theory on efficiency and equality. Unfair discrimination relating to individuals will then be looked at, after

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1 Differences between the approach taken by countries ruled by religious laws, democratic principles and communist ideologies are clearly discernible.

2 De Waal, Currie and Erasmus (2001:200).

which there will be a brief discussion on whether the test for unfair discrimination amongst individuals can be applied to states. A synthesis of legal and economic principles will follow, culminating in a discussion as to how a test for unfair discrimination can be applied within the GATT context.

2.2 Economic theory

2.2.1 Efficiency and Pareto

Efficiency is to economic theory what justice is to legal process. Both provide a means of measuring the effectiveness of these disciplines. Economic efficiency refers to efficiency in the use and allocation of resources. In the use of resources, economic efficiency requires that any given output is produced at minimum cost, which means both that waste and technological inefficiency are avoided and that appropriate input prices are used to find the cost minimising production processes. Optimum efficiency is called "Pareto optimum" and may be formulated as an equilibrium situation in which no change can be made to benefit some Alpha without injuring some Beta.[3] In his discussion on maximum utility, Pareto[4] states:

> "When the community stands at a point Q,[5] that it can leave with resulting benefits to all individuals, procuring greater enjoyments for all of them, it is obvious that from the economic standpoint it is advisable not to stop at that point, but to move from it as far as the movement away from it is advantageous to all. When, then, the point P, where that is no longer possible, is reached, it is necessary as regards the advisability of stopping there or going on, to resort to other considerations foreign to economics - to decide on grounds of

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3 Samuels (1974:200). The terms Alpha and Beta are used to distinguish between two individuals A and B.

4 Pareto (1935:2129).

5 The relevance of point P and Q, in this context, lies not in what they are but what they signify. While point P represents a decision based upon sacrifice, point Q represents a decision which does not require sacrifice. Rather, all individuals are treated equally. Movements at point P are beneficial to certain individuals while being harmful to others. Movements of type Q, will either benefit all, or harm all individuals without exception.

ethics, social utility, or something else, which individual it is advisable to benefit, which to sacrifice."

In his commentary on Pareto, Samuels states that a Pareto optimum is essentially a solution to the problem of reconciling continuity and change concerning the distribution of sacrifice, a decision rule governing the condition under which change is permissible. A Pareto optimum allows for change if and only if there is no visitation of injury on some Beta for the advantage of some Alpha or as a necessary consequence of the benefit given some Alpha.[6] Pareto optimum criteria rest on the situation in which the original distribution of resources is taken for granted. This includes the system of property relations and distribution of property rights. It also assumes the existing distribution of power and sacrifice in society.[7] With the existence of uncertainty in a society composed of many individuals, each for the most part unaware of the preferences of fellow individuals, rules of conduct are required for the successful integration of a specialised economy. Fundamental to the emergence of such rules of conduct is the existence of an effective system of property rights which encapsulates strict rules of ownership, modification and transferability of property within the private domain. Liberals see the role of common law as providing the basis for realisable expectations and in establishing rules for the protection of all individuals from the seizure of their rights as being of central importance to the preservation of a liberal order.[8]

Liberals acknowledge the role of the courts in the protection of property rights, stating that the judge

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6 Samuels, op cit note 3 at 201.

7 Sacrifice relates to the decision of who is to be made worse off while others are made better off.

8 Rowley (1983:36-7).Property, according to liberal theorists, is an exclusive right. Originally, the exclusiveness of property rights was derived from the nature of rational man in a society in which not all men where equal. Upon the assertion that all men are equal, the derivation of exclusive rights fell away. The derivation of exclusive property rights now rests on the postulate that a man's labour is his own. The labour justification of property has the effect of reinforcing the concept of exclusiveness. The labour of a man's body and the work of his hands is seen as exclusively his. The right to that with which he has mixed his labour is thus an exclusive right. Bentham and other liberal theorists, for example, Mill and Green, have accepted the labour justification of property, with Bentham stating that security of enjoyment of the fruits of one's labour was the reason for property: without a property in the fruits and in the means of labour no one would have an incentive to labour, and utility could not be maximised, Macpherson (1978:203-4).

should not be concerned about the wider social implications of his judgments. The rule of law requires that all laws should conform to a set of principles. Laws must, firstly, be prospective and never retrospective in their effect, because the intention is always to influence future choices. Second, laws must be known and certain, so that individuals are in a position accurately to predict the decisions of the courts. Lastly, laws must apply with equal force to all individuals, including those who govern, without exception or discrimination. This provision, in particular, is important to the liberal order as it serves to lower the probability that a liberal order will be overthrown by the coercive legislation of a passing government majority coalition.[9]

2.2.2 Neoclassical economics and general equilibrium theory

In addition to articulating his optimum, Pareto is widely regarded as a founder of welfare economics and a pre-eminent contributor to neoclassicism in economics.[10] Neoclassical economics seeks to "combine the virtues of the isolated individual with the advantages of social cooperation." Social cooperation is really cooperation amongst individuals who maintain their status as free individuals and are not merely the means to the well-being of others.[11] This is the ideal. Within the neoclassical order people are rational, that is, they are enlightened and knowing. Freedom within this model means that everything which individuals do, they do willingly.[12]

Neoclassical or liberal theory is based upon three crucial assumptions about market exchange. These are the assumptions of rationality, egoism and freedom. Individuals are deemed to be rational to the extent that they choose the most efficient means of realising whatever aims they have. They therefore have to maximise their utility by calculating the costs and benefits involved in different courses of action. This leads to the second assumption of egoism. The unlimited egoism of market agents is derived from rational pursuit of whatever maximises their utility. While market agents are

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9 Rowley, op cit note 8 at 37-38.

10 Samuels, op cit note 3 at 198.

11 Mittermaier (1986:39).

12 Fryer (2001:9.21)

self interested, they are not selfish, because the pursuit of self interest occurs within an agreed framework of rules. These rules ensure that the pursuit of self interest coincides with the promotion of social welfare. There is a natural identity of individual and general interest because only those exchanges which benefit all parties are made. For such an outcome to be achieved the third assumption, freedom, has to be made. For the market order to work, individuals must be able to make choices freely. This means a minimum of restraints upon individual behaviour.[13] Freedom, within the liberal context, amounts to negative freedom, that is, the absence of coercion of some individuals by others. A person is seen as being unfree to the extent that he is prevented from doing something by the actions and plans of others.[14]

Freedom and the autonomy which comes from freedom, is linked to the prevention of power. Liberals see power as constituting a threat to individual freedom by offering the opportunity for certain individuals to impose their will arbitrarily upon others. Because power corrupts, those individuals with power over others tend to develop coercive and meddlesome behaviour over others. Liberals therefore advocate competitive capitalism as a means of eliminating and dispersing such power.[15] While freedom is important, a minimum of restraints upon individual behaviour are deemed important as they specify the conditions which must be created for a market order to exist and for the individual and general interest to coincide. Because the minimum cannot be provided by the process of market exchange itself, there is a need for a public authority. The main functions of the public authority are:[16]

a) to maintain legal equality between all market agents. Competition must therefore be fair and open, with all individuals being free to buy and sell;[17]

b) to maintain order and peace. Contracts must therefore be enforced and the security of property and persons guaranteed; and

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13 Gamble (1983:66-7).

14 Rowley, op cit note 8 at 29. For more on negative liberty, see Berlin (1969:122-131).

15 Rowley, op cit note 8 at 39. Power within the neoclassical context refers to the absence of coercion as opposed to the abuse of power.

16 Gamble, op cit note 13 at 67.

17 The liberal trading system advocated by the GATT/WTO, is based upon this premise.

c) to establish a medium of exchange and maintain its stability and acceptability.

Given the assumptions of neoclassical economics, the first theorem of welfare economics states that the general equilibrium of a perfectly competitive market economy is Pareto efficient. This theorem is deemed to be proof of Adam Smith's "Invisible Hand" theorem. Smith's theorem provides that while individuals neither intend to promote the public interest, nor know how much they are promoting it, intending only their gain, they are led by an invisible hand to promote an end which is not part of their intention. By pursuing their own interests, they frequently promote those of society more effectively than when they really intend to promote it. A limiting factor of the "invisible hand" is that it works best in an economy in which markets are working well or where they are perfectly competitive.[18]

In response to the accepted interpretation of Pareto efficiency, Campbell[19] has interpreted Adam Smith's theory as follows: "For Smith an action (or change) cannot be called socially beneficial if it involves injury or harm to other individuals. Such actions should be discouraged by means of the formulation of legal and moral rules."

While people are acting independently in their own private interests, the market results in social optimisation in a free society. The neoclassical model therefore rests upon the foundation of a free, democratic society. Pareto efficiency, as introduced by the neoclassical model, rests upon a foundation of formal equality; ie the point Q refers to equal opportunity for all to either benefit or lose from a market transaction. In accordance with the first theorem of welfare economics, all possible opportunities for benefit will be taken up by the people who are rational utility maximisers. This will result in the economy being efficient in equilibrium. There will also be a measure of fairness because there will not be any exploitation of people who are not aggressive bargainers.[20]

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18 Hall and Lieberman (2001:422). The distinction between market and state lies in the fact that a market is defined in terms of the fundamental forces of supply and demand, and is not necessarily confined to any particular geographical location. The state, however, is the public or governmental authority. Bannock, Baxter and Rees (1985:286-7; 413).

19 Campbell (1967:575). See section 2.2.1.

20 Fryer, op cit note 12 at 9.2.1.

Within the context of the level playing field of perfect competition, formal equity, as advocated by liberal theorists, can be equated to fairness. This does not necessarily mean that trade under perfect competition produces fair outcomes. Where there are many consumers trading in a formal market, the gains from trade might be fair, but the consumers might have started off in highly unequal positions. Trade in market economies will not solve problems of prior inequality.[21]

There are two main critiques of the first theorem of welfare economics. The first is that formal equity is a limited goal which is clarified by the second theorem. The second critique is that the first theorem relies heavily on perfect competition. Power removes the separation between equity and efficiency, leading to second best outcomes. These shortcomings of the first theorem of welfare economies provide a role for the government, with the government making sure that the initial allocation is reasonably fair by ensuring that people's incomes are reasonably similar. The market will then do the rest because people trade to an efficient outcome from any starting point. The second theorem of welfare economics can therefore be stated as follows: given the assumptions of neoclassical economics, for any Pareto optimal allocation that is attainable, there is a distribution of income such that the competitive market economy solves to that particular Pareto optimal allocation.[22] Put simply, the second theorem states that, under relatively unrestrictive conditions, any allocation on the contract curve can be sustained as a competitive equilibrium.[23]

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21 Fryer, op cit note 12 at 8.2.1.

22 Loc cit.

23 Frank (1997:565-6). An indifference curve is a set of bundles that the consumer prefers equally. A contract curve shows the various combination of choices which consumers can make between goods where there is trade between individuals. A major problem with the second theorem of welfare economics is pointed out by Arrow in his "impossibility theorem". Arrow's theorem is concerned with investigating the ways of constructing a social welfare function. When the only information available is the preference orderings of the individual households and the planner is prevented from making interpersonal comparisons of welfare. According to this theorem, if we wish the social orderings to satisfy certain value judgments, that is, the Pareto principle, the independence of irrelevant alternatives and unrestricted domain, and we restrict the planner from making interpersonal comparisons, then the only possible ordering is that of a dictatorship (Broadway and Bruce, 1984:16, 167). Put simply, Arrow has shown that it is generally impossible to construct a set of rules for making social choices that is at once comprehensive, democratic, efficient and consistent (Lipsey, Courant, Purvis and Steiner, 1993:412). Sen (1970) provides another criticism of the second theorem of welfare in his liberal paradox. He shows that the Pareto criterion can conflict with liberal values. Sen defines liberalism as a belief that every household should be decisive in the choice between at least one pair of choices. When externalities of utility

While the second welfare theorem appears to accept income redistribution, neoclassical economists state that it is not income itself that should be redistributed but the means for earning income. Education, which determines people's human capital and therefore wage income, should be equally accessible to all. Neoclassical economists accept that government can and should do something about wage income: this should, however, be done through education. It is on the question of what must be done about unearned income that neoclassical economists come unstuck. On this issue, they have raised the disincentive effect of not having an unequal distribution of income as this robs the poor of having something to aspire to. There is very little if any evidence that unequal societies perform better than relatively equal ones however. This conclusion highlights the fact that efficient outcomes are not necessarily equitable outcomes.[24]

From the conditions attached by neoclassical economists to the achievement of Pareto efficiency, it is clear that the Pareto optimum represents the ideal and is therefore axiomatic, unlike law which is more pragmatic. Because all people either benefit or suffer together, the neoclassical model rests on a foundation of formal equality. The fact that Pareto efficiency can only be achieved in perfectly competitive markets suggests a state of powerlessness.[25] Fair outcomes even within the limited context of formal equality can therefore be achieved only if the playing field is level. Given the assumptions of liberal theory powerlessness can only occur where individuals begin on an equal footing.

Neoclassical economics, in attempting to keep equity and efficiency separate, steers clear of having to make ethical judgments. While the first and second theorem of welfare economics allow for fairness, the first theorem does not address the problem of existing inequalities. The question therefore remains as to how to achieve efficiency and fairness within a system of power. While neoclassical economics does not, through Pareto optimum reasoning, address the issue of sacrifice,

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exist, ie, one household's choice alters the utility of another, the goal of liberalism can conflict with the Pareto criterion. A state which is preferred according to the Pareto criterion may conflict with neoclassical assumptions (Broadway and Bruce, 63).

24 Fryer, op cit note 12 at 9.2.

25 Loc cit.

Pareto referred to the need to resort to other considerations foreign to economics, such as law, to address this problem. Pareto later stressed that economics must be part of a larger general sociology because of the interdependence of nominally economic and sociological variables.[26]

A first best economy exists when all the conditions of neoclassical economies are met. In a first best situation, formal equity is achieved and is sufficient. Formal equity works within this situation because the conditions necessary for freedom prevent power. More importantly, the protection of property rights ensures that individuals do not infringe upon the rights of others, even when acting as rational maximises.[27] Where one of the conditions necessary for the achievement of a perfectly competitive market structure or first best market is unattainable, however, we have a second best situation. The general theorem of second best provides that, in general, if one of the conditions necessary to achieve Pareto optimality is unattainable, the others, although still unattainable, are undesirable.[28] In the absence of freedom, which is linked to formal equity, second best is invoked.

The general theorem of second best states that if one of the Pareto optimum conditions cannot be fulfilled, a second best optimum situation is achieved only by departing from all other optimum conditions.[29] Second best situations imply the use of power, for example, monopoly as opposed to perfect competition. Neoclassical general equilibrium theory views market power as bad. The ideal, as found in a first best situation, is when nobody has any power in the market. Neoclassical assumptions provide that competition will ensure a return to powerlessness. The theory of second best shows, however, that as soon as we have any barriers to competition, so that economic power becomes inevitable in some parts of the economy, it is doubtful whether reducing economic power in some sectors will increase welfare.

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26 Samuels, op cit note 3 at 9. Where inequalities exist at the initial position, the interests of those who are better off may have to be temporarily sacrificed in order to improve the welfare of those who are worse off, and so address existing inequalities.

27 Fryer, op cit note 12 at 8.2.

28 Lipsey and Lancaster (1956:12). See also Fryer and Newham (2000:25-27).

29 Rees (1984:38).

Second best does not, therefore, seek to return to the ideal but rather to balance power within the market. Where the attempt to achieve balance fails, we get dominance or market failure. The theory of second best seems to show that the conclusion that market economies are optimal is extremely sensitive to the validity of the methodological assumptions of neoclassical economics. The second best theory therefore correctly points out that piecemeal policies which try to make bits of the economy look like the ideal are misguided. The most important lesson of second best theory is, however, a positive one, ie, that policy should always be fundamental. Policy should therefore, where possible, aim at addressing the original source of the problem. The principal insight of second best theory is not the vulnerability of core propositions to violations of the assumption. It is, rather, that the best policy option is always to fix the underlying problem rather than surface manifestations. Only where this is impossible is second best resorted to. Second best policy is therefore papering over the symptoms.[30] First best solutions or solutions which deal specifically with the particular problem are therefore to be sought before seeking outcomes which balance power.

The Pareto optimum provides a number of key points to be considered when determining fairness. The first best economy is based upon and links efficiency to a foundation of freedom, rationality and equality, albeit formal equality. The Pareto optimum, in addition to prescribing the conditions for achieving efficiency, also provides a means of determining fairness. From the Pareto rule it may be deduced that fairness is deemed to be dependent upon the preservation of individual rights. This conclusion represents the ideal however. The Pareto optimum is based upon the assumption of a level playing field. This is possibly the only way in which an action could benefit or be to the detriment of all, at the same time. Where a level playing field exists, a separation of efficiency and equity is possible as in a position of powerlessness the market may operate at an optimum, with all people being treated fairly, regardless of their bargaining position. Because formal equity is linked to properly defined property rights, powerlessness can be achieved through the inability of individuals to infringe upon the rights of others. Formal equality will provide for freedom and autonomy in this model as people all have the same chance of success or failure.

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30 Fryer, op cit note 12 at 8.5.1.

2.2.3 Coase

Coase,[35] in his discussion of the social cost of nuisance cases, seeks to determine an economically efficient outcome. Coase contrasts the role of the courts in an ideal situation against their actual role. He concludes that, if market transactions were costless, all that the courts would be concerned with (apart from matters of equity) would be that the rights of the various parties should be well-defined and the result of legal action easy to forecast. Because market transactions are costly, the courts directly influence economic activity. It is therefore necessary for the courts to understand the economic consequences of their decisions and they should take these consequences into account when making their decisions.[36] While the ideal might be a separation of economic and legal consequences, the law operates in a world ruled by power and is therefore forced to take into account both economic and legal consequences as a means of balancing this power and achieving fair legal outcomes. Coase states that the problem faced with when dealing with actions which have harmful effects is not simply one of restraining those responsible for them. What has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produced the harm.[37] In the absence of first best circumstances, particularly well-defined property rights, the courts have to resort to utilitarian type reasoning, and seek to balance power rather than enforce individual rights, as would occur within a first best situation.

From his analysis of legal cases, Coase concludes that when the parties affected by externalities can negotiate costlessly with one another, an efficient outcome results no matter how the law assigns responsibility for damages. This is a first best outcome based upon the second theorem of welfare. This conclusion is known as the Coase Theorem and at its simplest merely states that the most efficient laws and social institutions are the ones that place the burden of adjustment to externalities on those who can accomplish it at the least cost. In reaching his conclusion, Coase worked on the

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35 Coase (1960:1-44). See also Harris (1997:46-48).

36 Coase, op cit note 35 at 19.

37 Coase, op cit note 35 at 27.

assumption that, given zero transaction costs, every property right would end up vested in the person who values it most, with value being determined by each party's willingness to pay. Where transaction costs frustrate such re-allocations, the law should impose the most efficient solution.[38] An efficient outcome is dependent, however, on the markets operating perfectly.

While Coase's conclusions have been applied, with modification, in substantive and procedural law, Harris disagrees with the utilitarian approach adopted by Coase in the situation of externalities and costly negotiation. He points out that in the economic analysis of law, people are prepared to pay for what they want, either in money or by the deployment of some other resource, such as time and effort. This calculation of utility is objectionable in principle, however, because the advantages to some cannot be measured against the disadvantages of others.[39] Harris's objections bring us to a very important difference between law and economics. While neoclassical economics rests on the premise that interpersonal comparisons of individual utility are not to be made, in order to balance power between individuals and groups the courts are forced to make this very judgement. In the interest of fairness the courts have to look beyond who has the most money or who is prepared to sacrifice the most and consider issues of equality and justice.

2.2.4 Economic discrimination

2.2.4.1 Becker and Posner

The Pareto optimum states that the ideal is reached when no one else can be made better off without making anyone else worse off. This rule is, in itself, a moral statement, as it suggests that all people are equal and are therefore not to benefit at the expense of others. Moreover, it is an ideal situation. Where people cannot avoid interfering with the rights of others, the Coase Theorem appears to suggest that balancing of rights should occur at the least cost to the person or group whose rights are being sacrificed. Although he does not say so, it is possible to infer from Coase that as with any

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38 Harris, op cit note 35 at 46.

39 Loc cit.

utilitarian mechanism the balancing of powers requires an element of proportionality.[40] Both Pareto and Coase are mindful of the harm which might be done and value the rights of individuals highly. Pareto's ideal is one in which people benefit without harming others. While Coase makes allowance for discrimination, this must be done fairly, with minimal harm being done to those whose rights are being sacrificed. Neither Pareto nor Coase make allowance for the indiscriminate abuse of individual rights in any circumstances. From these two economic principles, it is evident that unfair discrimination[41] does not meet even the basic economic moral requirements, as it is not concerned with the rights of individuals or the harm visited upon those whose rights are sacrificed.

In his discussion of labour market discrimination, Becker[42] shows how markets react to discrimination. Looking at the discrimination against black workers by white employers, Becker found that if black and white workers were perfect substitutes in the production process, employer discrimination would lead to the segregation of black and white workers in the labour market and to unequal pay for equal work. The firm's discriminatory behaviour also reduces profits.[43] Decreased profits result from the fact that while the employer's perceived cost of hiring black people exceeds the actual cost, hiring of the preferred white labour is actually more costly than it appears to be. Within perfectly competitive markets, employers pay for the right to discriminate from their own pockets. This is a conclusion which Posner would support.[44] According to Posner, there are economic forces working in competitive markets which minimise discrimination. The formal equality definition, which is linked to achieving well-defined property rights, prevents discrimination within a market setting. These forces are, however, blunted in a market either monopolised or controlled by the government. In a market of many sellers the intensity of the prejudice against black people may vary considerably. Those sellers with only a mild distaste against

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40 Proportionality within this context refers to legal proportionality, this is, the means employed must be justified by the aims sought to be achieved. The impact of an act upon relevant groups is therefore important.

41 Unfair discrimination within the legal context.

42 Becker (1971:1959).

43 Borjas (1996:355).

44 Posner (1972:295).

them will not forego as many advantageous transactions with black people as their more prejudiced competitors. Their costs will therefore be lower and this will enable them to increase their share of the market.[45]

An important conclusion which can be drawn from above is that, while perfectly competitive markets minimise discrimination by penalising discriminatory behaviour and rewarding equal treatment, the same regulatory system does not occur within imperfect markets. The role of power within imperfect markets is one of undermining the proper functioning of the markets by negating the impact which the requirements of equality, rationality and freedom have had on the market. It is therefore left to the law, government and regulatory organisations to adopt policies which remove the symptoms of power, such as discrimination, and restore a measure of fairness to the market. Discrimination, in addition to being a symptom of power, reduces or prevents efficient outcomes as it does not allow for the optimal use of resources. Within imperfect markets discrimination will therefore be responsible for decreased societal welfare as the costs to the many will be greater than the benefits to the few.

Becker and Posner do not represent the only economic approaches to discrimination. Pareto indirectly raises the issue of discrimination when he refers to the question of an Alpha benefiting at the expense of a Beta where this is conducive to increased welfare. This represents a step away from the ideal of equal treatment (formal) of all people where it increases individual and/or group welfare.

2.2.4.2 Utilitarianism

A different approach to the issue of discrimination, welfare and distribution is provided by the utilitarian school. The utilitarian is not primarily concerned with how welfare is distributed. The concern is with the maximisation of welfare. Where the utilitarian is faced with a choice between two societies, one in which welfare is equally distributed and the other in which gross welfare inequalities exist, he/she will choose as morally preferable that society in which total welfare is

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45 Posner, op cit note 44 at 295-96.

higher.[46] Morality, within this context, is linked to making people better off. The utilitarian regards any action which decreases the welfare of others with suspicion. The only acceptable reason for making someone worse off than he or she might otherwise be is if the welfare of others could be improved in this way to an extent that outweighs the first person's loss. Issues of fairness and equality are therefore not given precedence. These values are important to the utilitarian only to the extent that they contribute to the maximisation of welfare. Where the sum total of human welfare can be increased only by producing inequalities in welfare, the utilitarian will seek maximisation, rather than equal distribution.[47]

Questions of how wealth, resources and opportunities should be distributed are, however, of interest to the utilitarian, where they result in welfare maximisation. The basic argument states that a more equal distribution of opportunities, wealth and other resources is desirable insofar as it will maximise welfare. An argument put forward in favour of a more equal distribution of wealth and opportunities (resources) is the theory of diminishing marginal utility. At its simplest, this theory states that R1.00 given to a millionaire will make a negligible contribution to his or her welfare. The same R1.00 given to a beggar will make a much more significant contribution to his or her welfare. The R1.00 will thus maximise welfare more effectively if placed in the hands of the poor person than if placed in the hands of the millionaire. If we seek to maximise welfare, we therefore have good reason to transfer resources from the rich to the poor.[48]

There are, however, other factors against which the argument of diminishing marginal utility must be balanced. High productivity is deemed to require a structure of incentives to encourage people to work hard and invest. It therefore follows that strict equality of resources will rob individuals of strong and immediate incentives to work hard and in the long run bring about a fall in productivity and an overall decline in welfare. The maintenance of an equal distribution of resources will require constant interference with the market on a scale that is unprecedented, leading to impaired economic

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46 Simmonds (1986:31).

47 Simmonds, op cit note 46 at 16-17. See also Harris, op cit note 35 at 40-46 and McCaubrey and White (1999:276-78).

48 Simmonds, op cit note 46 at 32.

efficiency which will result in a fall in welfare. The strength of the utilitarian argument lies in its attitude towards distributive issues. Utilitarianism explains the way in which equality is traded off against productivity and economic efficiency. This trade off reflects the fact that the underlying concern is the maximisation of welfare, which is a goal towards which both redistribution and higher productivity can contribute.[49]

From the utilitarian argument, it is evident that positive discrimination, through redistribution, is a goal worth pursuing where it results in the maximisation of welfare. The theory of diminishing marginal utility is therefore an argument in favour of positive discrimination. Distributive issues do not stand alone, however, and are always part of a much larger strategy. In the case of economic discrimination, distribution is part of neoclassical economics and is dependent on efficiency criteria. This means that any policy which interferes with the actual market process cannot be condoned. More importantly, because the first best market is rights- based, no interpersonal utility comparisons can be made. Such comparisons would need to be done in order to determine the utility enjoyed by all individuals. On a more positive note, it has been established that within economic theory, discrimination can be either negative or positive, depending on its consequences. The market is not, however, a system which works on ethical judgments and moral standards, however, but simply responds to the data which it is fed. Where the overall goal is increased welfare, the trade off which is made between equality and welfare is not necessarily fair, nor is it intended to be.

2.3 Rawls

In his book *A Theory of Justice*,[50] Rawls provides an alternative to utilitarianism. Rawls rejects utilitarianism on two main grounds, stating that it ignores the distinctiveness of persons and defines the right in terms of the good. The principle of utility assumes that rationality requires us to trade off the welfare of some against the welfare of others. For example, the utilitarian will only condemn slavery as being wrong because the happiness of the owners is not sufficiently great to outweigh the

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49 Simmonds, op cit note 46 at 32-3.

50 Rawls (1972).

suffering of the slaves. The fault of this thinking is that it extends to society as a whole the principle of rational decisions for individuals. With individuals, the pleasure and pain is experienced by the same person. Utilitarians seek to weigh the pain of one person against the pleasure of another. There is no reason why the same principle should apply to decisions which must judge between different people. Utilitarianism treats people as lacking any distinctness. It sees them merely as receptacles in which welfare is to be maximised with the greatest possible efficiency.[51]

Utilitarianism also defines a right in terms of the outcome sought. It begins with an account of what state of affairs is desirable and defines right action as action that leads to such a valuable state of affairs. For classical utilitarians, happiness is the thing that matters the most.[52] Actions are therefore deemed morally right or wrong according to their tendency to increase or decrease happiness. Morality, within this context, is thus directly linked to welfare, with actions which increase welfare being more likely to be deemed moral, regardless of the ethical implications thereof. Utilitarianism does not therefore rest upon a foundation of rights.

Rawls views issues of justice as being more important than questions of happiness and welfare in the sense that it is only when we know that a desire or pleasure is just that we can regard it as having any positive value. He wishes to rather offer a theory that is neutral between different ideals and aspirations, differing personal ideas about what makes life valuable. The principle of justice therefore represents a framework which provides individuals with a fair opportunity to pursue their own goals and values.[53] While Rawls objects to the direct application of the rationality concept as applied within the utilitarian school, he is aware that rationality is an attractive and powerful concept. Rawls's rational people therefore do not act in a classically utilitarian way but rather in accordance with Rawls's view of rationality, which is an attempt to employ criteria of rational prudence in a manner consistent both with the distinctness of persons and with priority of the right

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51 Simmonds, op cit note 46 at 40.

52 Harris, op cit note 35 at 40-41. See Bentham for a classic approach to utility. It was he who adopted the maxim of "the greatest happiness for the greatest number."

53 Simmonds, op cit note 46 at 41.

over the good.[54]

Rawls begins by placing his rational people behind the hypothetical veil of ignorance. People in this situation understand the factors that influence rational choice and the laws and principles that regulate human affairs. As to their own position, they are ignorant as they are behind the veil of ignorance. This is known as the original position. The original position is merely a hypothesis used to answer the question - what is justice?[55] Justice in this context is the body of principles that persons in the original position would choose because they have to make sure that the principles chosen are fair however they find themselves placed when they discover their actual position in society. Rawls regards this view of justice as "justice as fairness". While Rawls does not attempt to predict what form of society is likely to result from the choices people make, he does put forward two fundamental principles that people in the original position could not fail to adopt. The first principle provides that each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. The second principle states that all social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle: and, (b) attached to offices and position open to all under conditions of fair equality of opportunity.[56] Through the provision of open positions under conditions of fair equality of opportunity, Rawls seeks to ensure that people at all levels of society have a fair chance of improving their position in society. Jobs and other positions are therefore to be open to all, with the means of accessing these positions being fair.

The freedom referred to by Rawls differs from the concept of freedom upon which the neoclassical model of economics relies. While Rawls refers to basic liberties, liberals rely on the concept of

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54 Simmonds, op cit note 46 at 41. Rational prudence refers to our acceptance that people do not simply exist for an instant to be replaced by other people. They have a continuous identity through time. Van Blerk states that while utilitarianism supports the position of a society organised for the greatest good of the greatest number. Rawls provides that this will not be accepted by those in the original position. According to Rawls, this still leaves a certain number of citizens whose good is not served. Unequal distribution of wealth is only permissible if it is to be for the benefit of all (Van Blerk, 1998:133).

55 Rawls, op cit note 50 at 12. See also Riddall (1999:209).

56 Rawls, op cit note 50 at 302.

negative freedom, stating that the essence of humanity lies in its capacity to choose. Restrictions upon such choices are to be accepted only where these freedoms run counter to each other, in which circumstances a prior ranking becomes essential. Freedom of choice is an end in itself because it forces individuals to confront the full responsibility for their own decisions.[57] Liberals rank freedom of choice in occupation and consumption ahead of freedom of contract and coalition. The reason for this ranking of the various freedoms lies in the fact that liberals advocate competitive capitalism as a principal method of organising production.[58] Freedom, as defined by liberals, is meant to prevent coercion between individuals, thus eliminating the possibility of power. Rawls refers to a much broader set of liberties, which include rights, powers and liberties. A difference between liberals and Rawls is that while liberals seek to prevent power play amongst individuals, Rawls acknowledges that an imbalance amongst individual positions is going to occur and seeks to ensure that, regardless of individuals' positions in society, they are not without rights and freedoms. The basic liberties referred to by Rawls are linked to fair outcomes and provide that individuals are not denied the right to improve their position in society, regardless of the system which individuals behind the veil may choose.

The first principle, also known as the principle of greatest equal liberty, takes precedence over the second. The basic liberties are to include the right to vote and to be eligible for public office, freedom of speech, freedom of assembly, liberty of conscience, freedom of thought, freedom of person, the right to hold property and freedom from arbitrary arrest and seizure. Jobs and other positions are therefore to be open to all, with the means of accessing these positions being fair. Given that Rawls has adopted redress as a means of addressing inequalities between individual or groups, it may be assumed that redress would be an important component of fairness, therefore allowing disadvantaged groups to access opportunities which would normally be closed to them.[59] The first principle seeks to maximise the extent to which citizens may enjoy these rights, powers and freedoms. The first principle is deemed to take precedence over the second because this ordering

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57 Rowley, op cit note 8 at 32.

58 Rowley, op cit note 8 at 39.

59 Rawls, op cit note 50 at 302-3.

means that a departure from the institutions of equal liberty required by the first principle cannot be justified, or compensated for, by increasing social or economic disadvantages.[60] According to Rawls, people in the original position value the principle of liberty above others because any restriction of liberty will obstruct their capacity to pursue all the other social good. As a result, liberty may only be restricted in order to defend other liberties.[61] Restrictions of the basic liberties may only occur:[62] (a) where the curtailment of one liberty will result in greater liberty overall, for example, the imprisonment of a dangerous criminal; or (b) where a less than equal liberty is accepted by those citizens with the lesser liberties. In the same way that economic inequalities are acceptable where they result in a benefit for all, so restrictions on the basic liberties are permissible where the overall result is increased liberty for all. While these restrictions may be utilitarian in approach, they occur within a highly regulated context and are not meant to be used indiscriminately.

The second principle, also known as the difference principle, deals with distribution of wealth, power and responsibility in society. Rawls is of the opinion that a society should allow just enough discrimination to ensure that the position of the worst off member of that society is as good as possible. Rawls's ideal of justice is tied to an equal sharing of social good. Equality to Rawls does not mean that all forms of discrimination should disappear. His is a substantive vision of equality, where justice will not allow inequality unless it furthers the position of the disadvantaged at the same time.[63]

The difference principle represents, in effect, an agreement to regard the distribution of natural talents as a common asset and to share in the benefits of this distribution whatever the distribution turns out to be. Those who are favoured by nature, may gain from their good fortune only on terms that improve the situation of those who have lost out. No-one deserves his or her greater natural capacity or merits a more favourable starting point in society. It does not, however, follow that one

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60 Rawls, op cit note 50 at 213.

61 Johnson, Pete and du Plessis (2001:184).

62 Riddall, op cit note 55 at 212. See also Harris, op cit note 35 at 283.

63 Johnson et al, op cit note 61 at 184.

should eliminate these distinctions. Another way to deal with them would be to arrange the basic structure so that these contingencies work for the good of the less fortunate. The natural distribution is neither just nor unjust, nor is it unjust for people to be born into different levels of society. What is just or unjust is the way in which institutions deal with these facts. The social system is not an unchangeable order beyond human control but a pattern of human action. To Rawls, the concept of "justice as fairness" works when people agree to share one another's fate.[64]

The difference principle gives some weight to the considerations singled out by the principle of redress, which holds that undeserved inequalities call for redress, and since inequalities of birth and natural endowment are undeserved, those inequalities must somehow be compensated for. While it may appear that Rawls sees undeserved inequalities as unjust, this is not the case. Where people are born into different levels of society, Rawls states that these tiers of opportunity are neither fair or unfair. The issue of redress is linked to the opportunities which avail themselves to an individual once within a particular system. Where an individual is disadvantaged this is not a conscious choice made by them at birth and cannot be remedied. What can be changed are the opportunities which are available to them in life. The issue of injustice arises when the position of a person's birth influences and determines their life choices, thus restricting the opportunities open to them. Justice as fairness provides that regardless of a person's birth situation, he or she must be given a fair opportunity to improve on their initial position. Where individuals are advantaged, these opportunities must be linked to increased opportunities for the disadvantaged. The redress principle holds that in order to treat all people equally, to provide genuine equality of opportunity, society must give more attention to those with fewer native assets and to those born into less-favourable social positions. The idea is to redress the bias of contingencies in the direction of equality. The principle of redress is to be weighed against other principles, for example, the principle to improve the average standard of life or to advance the common good. Whatever principles are upheld, however, the claims of redress are to be taken into account as redress represents one of the elements of our conception of justice.[65]

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64 Rawls, op cit note 50 at 101-102. See also Harris, op cit note 35 at 284-85.

65 Rawls, op cit note 50 at 100-101.

The difference principle is subject to two subordinate principles, the just savings principle and the principle of fair equality of opportunity.[66] The principle of fair equality of opportunity is designed to secure equal access for everyone to all opportunities in the society. Rawls also calls this the principle of open positions. According to Rawls, it may be possible to improve everyone's situation by assigning certain powers and benefits to positions despite the fact that certain groups are excluded from them. While access is restricted, these offices can still attract superior talent and encourage better performance. The principle of open positions forbids this. It is based on the conviction that if some places were not open on a fair basis to all, those kept out would be right in feeling unjustly treated even though they benefited from the greater efforts of those who were allowed to hold them. Their complaint would be justified not only because they were excluded from certain external rewards of office such as wealth and privilege but because they would be prevented from experiencing the realisation of self which comes from a skilful and devoted exercise of social duties, which is one of the main forms of human good.[67]

Rawls, in his *Theory of Justice*, has done much to reduce the gap between economics and law. A specific area in which Rawls has made inroads is that of rationality. According to traditional economic theory, the rational person seeks to maximise his or her self-interest and shows only limited concern for the well-being of others. However, the reasonable person, as found in legal theory, will ordinarily behave in a reasonable, prudent manner, which includes fair regard to the welfare of others.[68] While Rawls has adopted the approach of the rational person, he has endowed the person with the characteristics of the reasonable person, ie the ability to maximise his or her own self-interest while showing concern for the well-being of fellow people. The ability to endow this rational person with distinctiveness and social conscience stems from the fact that Rawls is not

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66 The just savings principle is designed to secure justice between generations. It requires that each generation put aside a suitable amount of resources as a contribution to future generations. This principle ensures that justice is not only done between members of a society at a given time, but also between members of that society and succeeding generations of that society. Rawls calls this justice between generations and argues that people should not squander resources, and leave nothing for future generations. Johnson et al, op cit note 61 at 185. See also Riddall, op cit note 55 at 210 and McCaubrey and White, op cit note 47 at 304-5.

67 Rawls, op cit note 50 at 84.

68 McCaubrey and White, op cit note 47 at 278.

limited by the theoretical parameters or assumptions of economic theory. The rational person defined by Rawls has more in common with the rational utility maximisation of economies, than the rational person referred to by utilitarianism, who places welfare maximisation above the social good and the rights of his fellow human beings.

Liberal theory limits the maximisation of individual welfare, with individuals being aware of and being expected to respect the rights of other individuals. The difference between Rawls's rational person and the rational people envisaged by neoclassical theory is that Rawls expects his rational person to act bearing in mind the interest of those who are worse off than he/she if they seek to improve their own welfare. Neoclassical theory does not go as far. This may, however, be due to the assumption of a level playing field. While Rawls's rational people were created to fulfil a role in a hypothetical scenario, because of the purpose of their construction, they are more real in terms of their attributes. Rawls's interpretation of rationality and reason provides a good example of the difference between axiomatic and pragmatic thinking, and between law and economics.

An issue which is of great importance to this discussion is Rawls's approach to welfare. While the Pareto optimum stops at the point where someone is made better off without making anyone else worse off, Rawls shows that formal equality is not necessarily the way in which welfare will be maximised. Unlike the Pareto optimum, which requires only that people do not benefit at the expense of others, the aim of a first best situation is that everyone benefits. The goal of first best is therefore the same as that of Rawls, in that they both seek to provide an outcome in which everyone benefits. The biggest difference between first best and Rawls, however, is that first best rests upon the assumption of a level playing field while Rawls seeks to deal with a situation where the playing field is uneven. There is therefore inequality in the starting position.. Rawls begins from a more realistic standpoint and acknowledges inequalities which will always exist. According to Rawls, application of the difference principle will ensure that people are treated fairly within society, with everyone being guaranteed increased welfare, rather than some benefiting at the expense of others. Rawls differs from the Pareto optimum and neoclassical theory in that he begins with a set of basic liberties which are applicable to all equally and cannot be reduced in order to ensure greater societal wealth or welfare. Rawls has also accepted that certain inequalities will exist in society and may

actually be necessary to ensure that society functions efficiently. He does not seek an equal distribution of wealth in society but merely that all people be treated fairly and be given a fair chance to succeed.

Rawls's greatest contribution, within the context of this discussion, is the link between equality and efficiency. Within the ideal Pareto situation, everyone is treated equally. Within this context formal equality is linked to powerlessness due to the level playing field. Within the first-best economy, efficiency is linked to equal treatment. Rawls acknowledges that society is unequal and there is no level playing field. Nevertheless, welfare can be maximised by focussing on the issues of justice and fairness. While the Pareto optimum merely prescribes that someone cannot be made better off without making anyone else worse off, Rawls states that no one may be made better off without someone else benefiting from his/her achievement. The difference between the "ideal" and Rawls's view is that while the decision rule and neoclassical theory do not require any moral involvement of its rational people in the welfare of others, Rawls does. In a situation of power and inbuilt inequalities, Rawls shows that increased overall welfare is still possible. Increased welfare is however linked to positive discrimination which occurs through the principles of fair equality of opportunity and redress.

By making those people in society who are advantaged partly responsible for the welfare of the disadvantaged groups with society, Rawls provides a means of dealing with power within society, as the powerful in society are unable to use the less powerful as a means of improving their opportunities. While neoclassical economics seeks a similar goal to Rawls, no room has been made for addressing initial inequalities amongst groups as the model rests upon the level playing field assumption. With the neoclassical approach, the position of people at the starting position is irrelevant because any inequalities are neutralised by the conditions of formal equality and powerlessness. Thus, even where individuals have unequal power, such power cannot be utilised to influence outcomes. Through the process of formal equality, individuals are therefore able to benefit equally from commercial transactions. This approach is unrealistic, however, as power cannot be totally divorced from the bargaining process and will therefore influence outcomes, even in the context of procedural or formal equality. Through his difference principle and a substantive

definition of equality, Rawls provides a workable solution to power within markets, without resorting to second best solutions. Where there is no level playing field, society has to take responsibility for the well-being of all, especially those who are not well-off, if it is to increase the welfare prospects of all individuals and society in general.

Rawls accepts that inequality at the starting position does influence outcomes. Formal equality is not sufficient. Instead, there must be a means of addressing the inequalities of the starting position as only then can fair outcomes be achieved. The substantive approach is therefore a recognition of the role of power in negotiations. This approach also provides a means of neutralising power through redress and therefore returning to the conditions necessary for first best outcomes. Through differentiation, Rawls deals with the issue of inequality at the starting position, thus providing a workable solution to the problem posed by neoclassical economics regarding initial inequality and fair outcomes. An important point to be inferred from Rawls's discussion of justice is that equal outcomes are not necessarily fair outcomes. Where individuals operate on an uneven playing field, equal outcomes entrench existing inequalities, thus entrenching the power and economic inequalities between these groups. This is an unacceptable outcome as equality is not merely process based. Through the difference principle and a substantive vision of equality amongst Rawls shows that unequal outcomes secure greater equality amongst individuals if they enable those individuals who are worse off to improve their welfare without decreasing the welfare of those who are better off in society. It is this focus on eliminating inequalities amongst individuals and neutralising power through redress which makes Rawls's theory of justice so appealing. While Rawls has been criticised,[69] his ideas on substantive equality have been accepted as part of modern legal doctrine and greatly changed the way in which discrimination is viewed.

2.4 Equality and legal discrimination

The focus of this chapter has, until now, been an economic one, with issues of efficiency, welfare, fairness and equality being discussed within the economic context. However it is also important that

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69 See Harris, op cit note 35 at 286-87 and Van Blerk, op cit note 54 at 133-135.

the legal view on issues of equality and discrimination be understood if a test for determining unfair discrimination is to be attempted. In this section, unfair discrimination amongst individuals will be discussed before any analysis of whether these principles can be applied to states ensues.

2.4.1 Unfair discrimination amongst individuals

Article 7 of the Universal Declaration of Human Rights provides that "all are equal before the law and all are entitled without discrimination to equal protection of the law. All are entitled to equal protection against any discrimination in violation of this Declaration and against incitement to such discrimination." The right to equality has been adopted by many states[70] and can be found in the human rights charters and conventions of the Organisation of African Unity, the United States of America and the European Union.[71] These states and regional groupings have recognised that all persons should have the free and full exercise of the rights and freedoms recognised by the various charters, without any discrimination for reason of race, colour, sex, language, religion, political or other opinion, national or social origin, economic status, birth or other social conditions.

McIntyre J, in *Andrews v Law Society of British Columbia,*[72] stated that "the promotion of equality entails the promotion of a society in which all are secure in the knowledge that they are recognised as human beings equally deserving of concern, respect and consideration. It has a remedial component." Goldstone J put forward a similar view in *President of South Africa and Another v Hugo*[73] when he stated that "at the heart of the prohibition of unfair discrimination lies a recognition that the purpose of our constitutional and democratic order is the establishment of a society in which all human beings will be accorded equal dignity and respect regardless of their membership of

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70 See, for example, Section 9 of the South African Bill of Rights; Article 3 of the Basic Law for the Federal Republic of Germany; and Section 1(b) of the Canadian Bill of Rights.

71 Article 1.1 of the American Convention on Human Rights. See also Article 2 of the African Charter on Human and People's Rights and Article 4 of the European Convention for the Protection of Human Rights and Fundamental Freedoms.

72 56 DLR (4th) 1 at 15.

73 1997 (6) BCLR 708 (CC) at 729 para 41.

particular groups." McLachlin JA, in *Re Andrews and Law Society,*[74] discussed the Canadian equality provision and stated that "the essential meaning of the requirement of equal protection and equal benefit is that persons who are similarly situated be treated similarly and conversely, all people who are differently situated be differently treated."

McLachlin JA incorporated as part of the requirements of equal treatment both a formal and substantive element. Formal equality requires sameness of treatment, with individuals being treated in the same manner, regardless of their circumstances. Substantive equality takes these circumstances into account and requires the law to ensure equality of outcomes.[75] While the Courts recognise the place of formal equality,[76] substantive equality has been established as a means of ensuring equal treatment of groups who are dissimilarly situated. In *President of the Republic of South Africa and Another v Hugo*[77] Goldstone J stated that "we need, therefore, to develop a concept of unfair discrimination which recognises that although a society which affords each human being equal treatment on the basis of equal treatment and freedom is our goal, we cannot achieve that goal by insisting upon identical treatment in all circumstances before that goal is achieved.[78] In the same case O' Regan J,[79] stated that "to determine whether the discrimination is unfair it is necessary to recognise that although the long-term goal of our constitutional order is equal treatment, insisting on equal treatment in circumstances of established inequality may well result in the entrenchment of that inequality."

The European Court of Human Rights has endorsed the *Andrews* comparability test. According to

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74 27 DLR (4th) 600 at 605.

75 De Waal, Currie and Erasmus op cit note 2. See footnote 2.

76 As with the Pareto optimum, formal equality would be the ideal means of ensuring equality through the courts. Given the uneven playing field, Courts have come to recognise that formal equality does not necessarily promote fair outcomes. Rawls's difference principle has therefore had an important role to play in the evolution of equality legislation.

77 1997 (6) BCLR 708 (CC) at 729 para 41.

78 *President of the Republic of South Africa and Another v Hugo.*

79 p 755, para 112. 1997(6) BCLR 708 (CC) at 755 para 112.

this Court, Article 4 (the equality provision) will be breached where, without objective and reasonable justification, persons in relatively similar situations are treated differently.[80] It must therefore be established that, amongst other things, the situation of the alleged victim can be considered similar to that of the people who have been better treated.

Not all persons are similarly situated, however. The Courts have also considered the situation where people are situated differently. In *Andrews v Law Society of BC,*[81] McLintyre J stated that mere equality of application to similarly situated groups of individuals does not provide a realistic test for the violation of equality rights. The classifying of individuals or groups, the making of different provisions respecting such groups, the application of different rules, regulation requirements and qualifications to different persons is necessary for governance of modern society. For the accommodation of differences, which is the essence of true equality, it will frequently be necessary to make distinctions. In the same case McIntyre J pointed out that every difference in treatment between individuals under the law will not necessarily result in inequality.[82]

The South African Constitutional Court, in *Prinsloo v Van der Linde and Another,*[83] has confirmed the Canadian position. In this case the Court stated that it must be accepted that, in order to govern a modern country efficiently and to harmonise the interests of all its people for the common good, it is essential to regulate the affairs of its inhabitants extensively. It is impossible to do so without differentiation and without classifications which treat people differently, and which impact on people differently. Differentiation, which falls into this category, very rarely constitutes unfair discrimination in respect of persons subject to such regulation, without the addition of a further element.

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80 ECHR, 18 February 1991, *Fredin*, Series A, no 192; ECHR, 28 September, 1995, *Spades and Scalabrina, Series A* no 31508. Lanotte, Sartin and Hereck (2001:31).

81 56 DLR (4th) 1 at 12,10.

82 This view was supported by Dickson CJC in *Regina v Big M Drug Mart Ltd* 1985, 18 DLR (4th) 321 at 362 when he stated that the interests of true equality may well require differentiation in treatment.

83 1997 (6) BCLR 759 (CC) at 771 para 24.

The relevance of the aforementioned judgments lies in the distinction which the various judges have made between people who are similarly situated and those who are not. For true equality to exist there has to be differentiation and the recognition of differences which exist between the various groups within society.

Recognition of differences between people and groups is arguably the most important step to be taken by states seeking to impose just laws upon their citizens. A simple example of such recognition exists within the tax structure of most states, with the poor being taxed much less than their wealthier counterparts, if at all. That the poor pay very little tax is a fact recognised and accepted by all as the reason for the differentiation is logical and coherent. To do otherwise is to impose a burden upon the poor which they can ill afford and would therefore be unjust. Equal treatment, according to the courts, cannot be interpreted to mean same treatment. A formal definition works best in a society devoid of differences amongst its people. Given the differences which exist between groups and persons in all societies, courts have chosen to put substance above form and adopt an interpretation of equal treatment which allows for fairness. To this end, differentiation has been accepted as a component of equal treatment and equality legislation. The substantive interpretation of equality enables the courts to go beyond uniformity and address the underlying issues which contribute to inequalities within society.[84] Through differentiation, courts are able to control the impact of their treatment of different groups and remedy inbuilt societal inequalities.[85] The concept of redress is a very important component of substantive equality and will be discussed in greater depth later.

2.4.1.1 Discrimination

Given that the equality principle encompasses both similar treatment and differentiation, when does

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84 The substantive definition of equality enables the courts to consider and address economic issues linked to injustice through the process of redistribution. This will, however, be discussed later in this Chapter.

85 This aspect of the equality provision is important as the purely economic approach envisioned within the first best economy, and based only on a formal approach to equality, is unable to remedy these existing inequalities. Because the markets are unable to remedy inequality, the courts have an important partnership role to play.

discrimination occur? But first a pertinent question is "what is discrimination?" The European Court of Human Rights has taken the view that not every distinction can be prohibited, only a discriminating distinction.[86] The Court held that the equality principle is violated if discrimination occurs when a distinction made between people or groups has no objective and reasonable justification. The existence of such a justification must be assessed in relation to the aim and effects of the measure under consideration, with regard being given to the principles which normally prevail in democratic societies. A difference in treatment must not only pursue a legitimate aim; the equality provision is likewise violated when it is clearly established that there is no reasonable relationship of proportionality between the means employed and the aim sought to be realised.[87] The European Court confirmed this decision in later judgments when it stated that a difference of treatment is discriminatory if it has no objective and reasonable justification, that is, if it does not pursue a legitimate aim or if there is not a reasonable relationship of proportionality between the means employed and the aim sought to be realised.[88] The European Court has adopted a two-pronged approach to determining discrimination. A distinction will be discriminatory where there is no objective and reasonable justification for such distinction. Even where the distinction has been adopted in pursuit of a legitimate aim, the means must justify the ends. Without such proportionality, a legitimate distinction may still be discriminatory.

In the Canadian case of *R v Oakes*[89] Dickson CJC linked the rational connection test to the proportionality provision, with the rationality provision being provided as being the first component of the proportionality provision. On the question of rationality, Dickson CJC noted that the measures

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86 ECHR, 23 July 1968, *Belgian Linguistic Case*, Series A, no 6.

87 ECHR, 27 October 1975, *National Union of Belgian Police*, Series A, no 19. While the proportionality test may have a utilitarian foundation, it is in itself a limiting provision as it is utilised to ensure that the negative impact upon the group being discriminated against is kept at a bare minimum and is justified by the increased welfare enjoyed by the group favoured by legislation. While the proportionality test provides a means of balancing welfare, it does not stand alone but is linked to the rational connection test, which provides an ethical component to the proportionality provision and ensures that welfare is not the original focus of any measure.

88 ECHR, 28 November 1984, *Rasmussen*, Series A, no 87; ECHR, 28 May 1985, *Abdulaziz, Cabales and Ballcondal*, Series A, no 94; ECHR, 18 July 1994, *Schmidt*, Series A, no 91-8. Lanotte et al, op cit note 79 at 126.

89 (1986) 19 CRR 308.

adopted must be carefully designed to achieve the objective in question. They must not be arbitrary, unfair or based upon irrational considerations. In short, they must be rationally connected to the objective. The High Court of Justice of Israel in *El-Al Israel Airlines Ltd v Danilowitz and Another*[90] commented on the reasoning to be adopted in connection with determining rationality. According to the Court, findings of discrimination cannot be dependent upon the discriminator's way of thinking and desires. Inequality may sometimes be justified by both legitimate and compelling reasons. To provide such reasons is a burden that would be difficult to discharge. From this judgment it may be inferred that rationality is objective and not subjective. The courts are not called upon to understand individual reasoning but rather to evaluate the discrimination by testing it against established principles, for example, the bill of rights.

McIntyre J, in the *Andrews*[91] case, defined discrimination as a "distinction", whether intentional or not, but based on grounds relating to personal characteristics of the individual or group, which has the effect of imposing burdens, obligations or disadvantages on such individuals or groups not imposed on others, or which withholds or limits access to opportunities, benefits and advantages available to other members of society." It is McIntyre J's opinion that the ideal of equality should be that a law expressed to bind all should not, because of irrelevant personal differences, have a more burdensome or less beneficial impact on one person or group than another.[92] The South African Constitutional Court in *President of the Republic of South Africa v Hugo*[93] stated that each case will require a careful and thorough understanding of the impact of the discriminatory action upon the particular people concerned to determine whether or not its overall impact is one which furthers the constitutional goal of equality.

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90 721/94 at para 17. For more on rationality see *Satchwell v President of the RSA and Another* 2001 (12) BCLR 1284 (T); *National Coalition for Gay and Lesbian Equality and others v Minister of Home Affairs and Others*, 2000(1) at para 56 and *Muller v President of the Republic of Nambia and Another* 2000 (6) BCLR 655 (Nms) at 666H and 667 G-J.

91 56 DLR (4th) at 18.

92 *Andrews v Law Society of BC* 56 DLR (4th) at 11.

93 1997 (4) SA1 (CC) para 41.

While the courts have referred to the analysis of differences in treatment between people or groups as a means of determining whether discrimination has occurred, there is, in fact, a difference between differentiation and discrimination. Legislation which recognises differences between groups of people who are dissimilarly situated and differentiates accordingly is not necessarily discriminatory. An example of such differentiation would be the provision of separate schools for children who are blind or deaf. The South African Constitutional Court has called this "mere differentiation". For mere differentiation not to be deemed discriminatory, it must pass the rational connection test ie a rational connection must be established between the differentiation in question and a legitimate government purpose.[94] The differentiation cannot be a mere exercise of power but must have a clear benefit for the disadvantaged group. This provision can be linked directly to Rawls's difference principle. Clarification of the rational connection test was provided by the Constitutional Court in *Prinsloo v Van der Linde*[95] when the Court stated that a constitutional state should act in a rational manner. It must not regulate in an arbitrary manner or manifest noted preferences which do not serve any legitimate government purpose. The reason for this aspect of equality is to ensure that the state is bound to function in a rational manner. In *S v Zuma and Others,*[96] the Constitutional Court stated that it cannot be too strongly stressed that the Constitution does not mean what we might wish it to mean. Even a constitution is a legal instrument, the language of which must be respected. If the language used by the law giver is ignored in favour of a general resort to "values" the result is not interpretation, but divination.

The courts have not only provided the test for discrimination but also considered which behaviours constitute discriminatory behaviour. The European Court of Human Rights has provided that the equality principle is violated when states treat persons in analogous situations differently without providing an objective and reasonable justification.[97] The right not to be discriminated against in the enjoyment of the rights guaranteed under the Constitution is also violated when states, without

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94 *Harksen v Lane*, 1998 (1) SA 300 (CC) para 53.

95 1997 (3) SA 1012 (CC) para 25.

96 1995 (2) SA 642 (CC) at 652J-653A.

97 ECHR, 6 April 2000, *Thimmenos*, *www.echr.cose.int* Lanotte et al, op cit note 79 at 134.

an objective and reasonable justification, *fail* to treat differently persons whose situations are significantly different. Legislation can therefore be considered discriminatory where, without reasonable and objective justification, states treat differently people who are similarly situated or fail to differentiate between groups who are dissimilarly situated. The determination of discrimination is in keeping with the two-pronged approach which the courts have taken in defining equality. An important development in the case law is the acceptance of differentiation as a legitimate component of the equality principle. This development indicates a clear movement away from the formal definition of equality to a substantive definition.

Discrimination goes beyond the determination of appropriate behaviour, however. Case law shows that it is necessary to determine both the reason for the different treatment and the impact of such legislation upon the affected group. The European Court refers to the determination of an objective and reasonable justification for the different treatment and the South African courts seek a rational connection between the regulation in question and a legitimate government purpose. Both these requirements operate to prevent arbitrary differentiation, with the state being accountable for its actions. The European Court defines proportionality as the extent to which the differentiation must be in keeping with the legitimate aims which the state has. Although this provision is also concerned with the impact of differentiation, it appears to encourage states to act with caution as acts which are not prudent could have negative circumstances on concerned groups. In *R v Oakes*[98] Dickson CJC on the question of proportionality states that the means, even if rationally connected to the objective in the first sense, should impair as little as possible the right or freedom in question. There must therefore be proportionality between the effects of the measures which are responsible for limiting the charter right of freedom, and the objective which has been identified as of sufficient importance.

In the South African case of *S v Makanyana and Another*,[99] Chaskalson P gave an in-depth commentary on the proportionality requirement. According to Chaskalson P the limitation of

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98 (1986) 19 CRR 308.

99 1995 (6) BCLR (CC) at para 104.

constitutional rights for a purpose that is reasonable and necessary in a democratic society involves the weighing up of competing values, and ultimately an assessment based on proportionality. The fact that different rights have different implications for democracy means that there is no absolute standard which can be laid down for determining reasonableness and necessity. Principles can be established but the application of those principles to particular circumstances can only be done on a case by case basis. This is inherent for the requirement of proportionality, which calls for the balancing of different interests. In the balancing process, the relevant considerations will include: the nature of the right that is limited, and its importance to an open and democratic society based on freedom and equality; the purpose for which the right is limited and the importance of that purpose to such a society; and the extent of the limitation, its efficiency, and particularly where the limitation has to be necessary, whether the desired ends could be reasonably achieved through other means less damaging to the right in question.

2.4.1.2 Fair and unfair discrimination

While the courts recognise that differentiation can be discriminatory, not all discrimination is unfair and therefore to be prohibited. Discrimination can therefore be either fair or unfair. In determining whether discrimination is fair or unfair, the South African courts take into account the impact of the discrimination on the complainant and others in his or her situation. In *President of the Republic of South Africa v Hugo*[100] the Court held that discrimination is fair where it seeks to achieve a worthwhile societal goal with the benefits to the few far outweighing any disadvantage which is suffered by those discriminated against.[101] In this case, the discrimination was used as a means of addressing a societal imbalance.

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100 1997 (4) SA1 (CC) paras 12, 37 39 and 40.

101 The sentiment expressed by the courts here can be found in Coase's approach to dealing with externalities where transactions are costly. Coase provided that what has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produced the harm. While the context of the reasoning differs, both Coase and the courts refer to the balancing of interests in order to determine fairness or efficiency. Where the interests of a group or individual are to be sacrificed, the court has a duty to ensure that the other person or group benefits with minimum harm being done to those being sacrificed.

When determining whether discrimination amounts to unfair discrimination, it is necessary to look beyond the rational connection test.[102] Where a rational connection can be found between discrimination and a legitimate government purpose, the discrimination may still violate the equality clause if it amounts to unfair discrimination. In *Prinsloo v Van der Linde*[103] the Constitutional Court stated that unfair discrimination principally means treating people differently in a way which impairs their fundamental dignity. In *Law v Canada (Minister of Employment and Immigration)*, [104] Iacobucci J, in his commentary on human dignity, states that human dignity is harmed by unfair treatment premised on personal traits or circumstances which do not relate to individual needs, capacities or merits. It is enhanced by laws which are sensitive to the needs, capacities and merits of different individuals taking into account the context underlying their differences. It is therefore not sufficient to ensure that a law passes the rational connection test and fulfills a legitimate government purpose. The impact of the legislation upon the affected groups must be taken into account as well. In *Muller v President of Namibia and Another,*[105] Strydom J stated that to determine the effect of such impact, consideration should be given to the complainants' position in society, whether he or she suffered from patterns of disadvantage in the past and whether the discrimination is based upon specified groups or not. Furthermore, consideration should be given to the provision or power and the purpose sought to be achieved by it with due regard to all such factors, the extent to which the discrimination has affected the rights and interests of the complainant and whether it has led to an impairment of his or her fundamental human dignity. This is not, however, a closed list.

Where the good effects of differentiation outweigh the harm caused, it is generally deemed to be fair

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102 De Waal, Currie and Erasmus, op cit note 2 at 203-4.

103 1997 (3) SA 1012 (CC) para 31.

104 (1999) 170 DLR (4th) 1 at para 5. See also *Dawood v Minister of Home Affairs* 2000 (3) SA 936 (CC) at para 35. The emphasis which the South African courts have placed on fundamental rights can be directly linked to the basic liberties established by Rawls. As with the rights in the SA bill of rights, Rawls's basic liberties are positive in that they are rights enjoyed by all citizens and can be limited only in very few circumstances. By linking discrimination to fundamental rights, the Courts have gone beyond the neoclassical and utilitarian value systems as they have a tangible means of evaluating legislation, behaviour or government action.

105 2000 (6) BCLR 655 (Nms) at 667 D-F.

as it is designed with that aim in mind. However, even where the differentiation is not arbitrary, but rational and in keeping with a legitimate government purpose, it may be unfair if the negative effects of the regulation on the group being discriminated against are greater than the positive effects being felt by those whom the differentiation favours. While a certain level of harm is acceptable, differentiation which causes undue harm is not acceptable. Such harm is, however, to be decided on the circumstances and is not absolute. The Canadian approach is much broader and appears to be more in keeping with the aim of equality, ie to improve the position of those groups in society who were previously disadvantaged or ensure a level playing field. McIntyre J's concept of unfair discrimination incorporates distinctions which have the effect of imposing burdens, obligations or disadvantages on one group which are not imposed on others, or withhold or limit access to opportunities, benefits and advantages which are available to other members of society. This definition encompasses both those inequalities which may have been imposed by legislation and those which are inbuilt. With its multidimensional focus, the Canadian approach is more in keeping with Rawls's difference principle as it seeks to maintain fundamental rights while providing the disadvantaged groups within society with fair equality of opportunity. McIntyre also provides a more concrete means of determining harm. His definition of harm can be linked directly the difference principle. While Rawls advocates differential treatment of differently situated groups, such treatment is conditional upon the improvement of the position of those who were better off in society. This is a position taken by McIntyre who states that the discrimination should not impose burdens on groups which are not experienced by other groups. Without a dual or multidimensional focus it may be unable to provide true equality and level the playing field.

In South African, unfairness has been linked to the impairment of dignity. This approach is linked to the type of inequalities found during the apartheid era, when some groups were denied their fundamental and basic human rights. The Canadian approach with its much broader definition of unfairness, encompasses all forms of inequality. The danger with the South African approach is that while the impact of the differentiation must be determined, the fact that an act can be unfairly discriminatory without impairing the dignity of the individual or group could be overlooked. The difference between fair and unfair discrimination is that with fair discrimination, the impact of the differentiation is proportional to the purpose it seeks to achieve.

The principles applicable to the determination of fairness amongst individuals may also be applied to states. Of particular relevance are the rational connection test and proportionality. While the South African approach to unfairness is appropriate to the South African context, the emphasis on impairment of dignity limits its application to individuals. Because states are judicial entities, they are without dignity. As a result, the South African test cannot be applied to states. Because of the limited application of the South African test for unfairness, the Canadian approach will be preferred in formulating a test for unfairness amongst states.

2.4.1.3 Redress

From the above case law, it is evident that differentiation and even discrimination have a role to play in the promotion of a more equal society. Discrimination is often used as a vehicle for remedial action, where it is necessary to restore balance to previously disadvantaged groups.[106] Affirmative action is a means employed by governments to restore balance to highly divided and disadvantaged areas of society.[107] Affirmative action provides preferential treatment for disadvantaged groups of people with affirmative action programmes requiring a member of a disadvantaged group to be preferred for the distribution of some benefit over someone who is not of that group.[108] According to De Waal, Currie and Erasmus affirmative action can be used as a means to the end of a more equal society. Equality is then seen as a long term goal, to be achieved through measures and programmes aimed at reducing current inequality. The equality provision goes further than simply prohibiting unfair discrimination or unequal treatment by the state or by private individuals. It also imposes a positive obligation on a government to act so as to ensure that everyone fully and equally

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106 Support for remedial action as a means of improving the lot of the disadvantaged in society can be found in Rawls' principle of redress. Differentiation as a means of providing redress is, in fact, one of the principles necessary for achieving fair outcomes and promoting equality amongst states. The substantive definition of equality rests on this principle as redress enables emphasis to be placed on fair outcomes as opposed to procedural fairness, alone.

107 While affirmative action is highly criticised, more room for complaint can actually be found in the means of implementation of this provision than with the provision itself.

108 De Waal, Currie and Erasmus, op cit note 2 at 223.

enjoys all rights and freedoms.[109]

De Waal, Currie and Erasmus therefore see affirmative action programmes as being essential and integral to the goal of equality with affirmative action being justified by its consequences. Measures which favour relatively disadvantaged groups at the expense of those who are relatively well off are not unfairly discriminatory because they promote equality. The measures chosen must, however, be intended or designed to achieve those desirable outcomes.[110] Mureinik[111] argued that the use of the word "designed" suggests that there should be a rational relationship between ends and means. It is therefore necessary to show both the purpose of the programme in question and the means selected are reasonably capable of meeting this purpose. Mureinik's view was supported in *Public Servants' Association of South Africa v Minister of Justice.*[112] The Court held that the words "design" and "adhere" denote a causal connection between the designed measures and the objectives. The Court's interpretation of the word "design" is in keeping with the rational connection test. An inference that can be made from this ruling is that even where the aim of legislation is one of redress, the test for rationality and therefore proportionality,[113] apply.

The equality clause would not, however, promote equal opportunity if it did not allow for redress. As much as governments must ensure that they do not discriminate unfairly between various groups, the equality principle also imposes a positive obligation on governments to redress existing imbalances already within society. Without this positive obligation, there cannot really be any change within unequal societies as governments will not see the need to provide disadvantaged groups within society with opportunities to grow and develop, thus improving their lot in life. Because of the unpopularity of programmes which promote redress, it is important that the positive obligation of governments or other authorities to promote change through redress be legally

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109 Loc cit.

110 Loc cit.

111 Mureinik (1994:31).

112 1997 (5) BCLR 577 (T).

113 The test for proportionality ensures that government considers the impact of its actions, even where rationality can be established.

entrenched. Without a legal commitment to redress, it is conceivable that attention will be paid to a form of redress, without commitment being made to substantial reforms. Without the aspect of redress, the equality principle, while it may prevent unfair discrimination, will not ensure that all individuals have the full and equal enjoyment of all rights and freedoms. Redress, then, through positive discrimination, seeks to ensure fair outcomes.

The redress principle is not merely a tool for affirmative action as through the positive obligation placed upon government or other administrative bodies, it acts as a mechanism for promoting the rights of the weakest in society. The principle of redress is also important for neutralising power play and preventing the abuse of power as it changes the balance of power to favour those without much power. It is the principle of redress which distinguishes formal from substantive equality and neoclassical economics from Rawls. While they all can be seen to protect liberty, it is only the substantive approach to equality as utilised by the courts and proposed by Rawls which places a positive burden on the state, in the case of individuals, to actively remove inequalities. Without the elimination of inequalities and neutralisation of power through a shift in power, positive liberty cannot be achieved. While the neoclassical model does provide for a system which eliminates power, the system relies on a negative approach, instead of a positive one. This is a problem as formal equality, in a system of unequal power which results from inherent inequalities, is not sufficient.

2.4.2 Unfair discrimination amongst states

While courts have formulated a test for determining unfair discrimination amongst individuals, there is no equivalent test for states. The focus of this section is to determine whether the provisions relating to individuals can be utilised within the context of states.

2.4.2.1 Equality

Article 4 of the Montevideo Convention on the Rights and Duties of States[114] provides that states are judicially equal, enjoy the same rights and have equal capacity in their exercise. The rights of each do not depend on the power which individual states possess to ensure the exercise of their rights, but upon the simple fact that states exists as an entity under international law. The Montevideo Convention is, however, an intra-American Convention with a limited number of contracting parties and is, as a result, not solid authority for the global equality of States. The Charter of the United Nations, on the other hand, is based on the principle of sovereign equality of its Members.[115] The goal of the United Nations is the creation of conditions of stability and well-being which are necessary for peaceful and friendly relations amongst nations and is based on the principle of equal rights and self-determination of peoples. Through the equality principle the United Nations seeks to promote higher standards of living, full employment and conditions of economic and social progress and development.[116]

2.4.2.2 Discrimination

Although the United Nations Charter does not deal with the principle of non-discrimination, an intermediate principle is developing amongst states on the topic. States and organisations, when taking measures in their own interests by way of extending most-favoured nation (MFN) treatment[117] or legitimately applying discriminatory legislation, are required to take into account the possible harmful effects of such steps on the economies of other countries.[118] Article 4 of the Charter on

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114 2002; *http://www.taiwandocuments.org/montevideo01htm* (22 February 2002).

115 Article 2(1).

116 Article 55(2), Charter of the United Nations.

117 Most-favoured nation treatment is the fundamental principle of the GATT and seeks to prevent discrimination within the WTO by requiring states to extend to the products of other Member States any advantages, favours, privileges, or immunities which they have granted to any other country. See WTO (1994:486).

118 Starke (1989:377).

Economic Rights and Duties of 1974 provides that states have the right to engage in international trade and other forms of economic cooperation irrespective of any differences in political, economic and social systems. No states are to be discriminated against in any way, based solely upon such differences. Article 24 of the Charter on Economic Rights and Duties of States provides that all states have a duty to conduct their mutual economic rights in a manner which takes into account the interests of other countries. All states are specifically tasked to avoid prejudicing the interests of the developing countries.[119] Within the WTO trading system, this idea has been adopted as one of the underlying principles, with Member states agreeing to extend more beneficial treatment to less-developed countries.[120] Special and differential treatment for developing economies[121] has been adopted as one of the exceptions to the MFN principle as it goes against the goal of treating all Member states the same. In practice, this has translated into the extension of preferential rates to developing states through the generalised system of preferences.

The emerging economic and GATT principles indicate a growing awareness amongst states that all states are not equal economically. With this awareness and recognition has come acceptance amongst states of the need to differentiate between the developed and developing economies. The acceptance, as a principle, of the need to extend more beneficial treatment to developing economies by WTO Members seems to indicate that Members recognise differentiation, not as an exception to the equality principle, but as a part thereof. The recognition of the need to differentiate amongst states is very important as it indicates a move away from a formal definition of equality to a more substantive one. The fact that the emerging economic principle requires states to be mindful of the harmful effect of their actions, even when discrimination is legitimate, is also important as it recognises that states are responsible for the impact of their legitimate actions upon the economies of other states. While this development may not appear to be very important, it does open a doorway for the argument that states should ensure that their regulations are proportional, thus limiting the

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119 Starke, op cit note 117 at 376. The Charter of Economic Rights and Duties of States is a UN Charter which was adopted by the UN Geneva Assembly Resolution. 328/XXXIX on December 12 1974.

120 WTO (1998:5).

121 Article XXXVI and XXXVII, WTO, op cit note 117 at 533-36.

harmful effects which they may have upon the economies of other states, especially developing states.

Developments within the WTO are extremely important to the question of equality. Prior to the GATT 1994 and the formation of the WTO, special and differential treatment of developing countries was seen as an exception to the MFN principle.[122] With the formation of the WTO, the extension of more beneficial treatment to developing economies has been adopted as an actual principle of the WTO,[123] and rates as equal to the MFN principle, which is another WTO principle. This elevation of the differential treatment of developing economies is an important development as it indicates a mind shift amongst Member States as to the place of differentiation. Recognition of differentiation as a GATT principle concretises the emerging principle which could be inferred from the actual GATT practice of extending preferential tariff rates to developing economies. Linked to the acceptance of differentiation by the WTO, is increased emphasis on the impact of WTO provisions on developing country economies.

The WTO has therefore paved a way for the acceptance of a substantive definition of equality amongst states, with differentiation and/or discrimination being part of the definition and an important component for ensuring equal outcomes. The equality principle, in this context, therefore provides for similarly situated countries to be treated similarly and dissimilarly situated states to be treated differently. Discrimination would therefore occur where similarly situated countries are not treated similarly or dissimilarly situated countries differently.

2.4.2.3 Fair or unfair discrimination

Article I.I of GATT 1994 provides that "with respect to customs duties and charges of any kind imposed on or in connection with importation or exportation, any advantage, favour, privilege or immunity granted for any other country shall be accorded immediately and unconditionally to the

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122 WTO, op cit note 117 at 486-7.

123 WTO, op cit note 122.

like product originating in or destined for the territories of all other contracting parties."[124] The MFN provision clearly prohibits a contracting party from according an advantage to a producer in another country while denying the same advantage to like products originating in the territories of other contracting parties.[125] Non-compliance falls foul of the non-discrimination provision with failure to comply, except where provided for by exceptions to Article 1.1, being discriminatory because it enables states to favour some trading partners above others.[126] The MFN principle is essentially an economic test which seeks to ensure, within the GATT context, non-discrimination between trading partners. Concessions made to one trading partner must be extended to all GATT Member states. The principle, together with other GATT provisions, seeks to further the WTO goal of increased liberalisation of markets through the decreased protection of domestic markets. Where protection falls foul of the MFN principle and other GATT provisions, it is considered discriminatory[127] and non-sanctioned protection of domestic markets within the GATT context also amounts to discriminatory behaviour.

The definition of equality applied here is a formal one, with emphasis being placed on sameness of treatment. The GATT approach to equality is consistent with and based upon the neoclassical approach which equates formal equality with fair treatment.[128] While the GATT MFN principle enables states to ensure that preferences and GATT provisions are administrated non-discriminately, it does not influence the way in which GATT provisions are negotiated, nor the outcomes of these negotiations. There is no GATT principle which ensures fair play in the negotiation of the Agreements themselves, or which compels Member states to refrain from infringing upon the economic rights of the other Member states through power play or to treat each other as true equals.

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124 WTO, op cit note 117 at 486.

125 Panel Report on "United States - Denial of Most-favoured-nation Treatment as to Non-rubber Footwear from Brazil", D518/R, adopted on 19 June 1992, 395/128, 151, para.6.11.

126 WTO, op cit note 120 at 5.

127 1988 Panel report on "Japan-Trade in Semi-Conductors," L/6309, adopted on 4 May 1988, 355/116, 115, para 12.2. The MFN principle does not stand alone, however. Once a measure has been found to be inconsistent with the GATT, whether or not it was applied discriminately, the question of its non-discriminatory administration is no longer relevant.

128 WTO, op cit note 120 at 5.

Developing economies have recourse mainly to the emerging economic principles and the UN Charter, which do not have much influence over the actions of the powerful GATT states.

The UN Charter promotes the sovereign equality of Member states and seeks to create conditions of stability and well-being which are necessary for peaceful and friendly relations amongst nations. The goal sought by the UN Charter is based upon the principle of equal rights and self determination of peoples. The issue of self determination was decided upon in the *Western Sahara Case.*[129] The Court emphasised that the right to self determination requires a free and genuine expression of the will of the people concerned.[130] The General Assembly Declaration on Principles of International Law concerning Friendly Relations and Cooperation amongst states in accordance with the Charter of the United Nations[131] clarifies the provisions of the United Nations Charter. In terms of the Declaration, every state has a duty to refrain from any forcible action which deprives people referred to in the elaboration of the principle of equal rights and self determination of their right to self determination and freedom and independence. States or groups thereof may not intervene, directly or indirectly, for any reason whatever, in the international or external affairs of any other states. Consequently, all forms of interference or attempted threats against the personality of the state or against its political, economic and cultural elements, are in violation of international law. States must therefore not use or encourage the use of economic, political or other type of measure to coerce another state in order to obtain from it the subordination of its sovereign rights[132] or to secure from it advantages of any kind. Rather, states should cooperate in the economic, social and cultural fields as well as the fields of science and technology and for the promotion of international cultural and educational progress.

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129 Advisory opinion, I.C.J Reports.

130 Paragraph 55.

131 GA Resn. 2625 (XXV), October 24, 1970.

132 Sovereign equality refers to the fact that all states are judicially equal, enjoy the rights inherent in full sovereignty and have a duty to respect the personality of other states. The territorial integrity and political independence of states are inviolable, with each state having the right freely to choose and develop its political, social, economic and cultural system. States also have a duty to comply fully and in good faith with its international obligations and to live in peace with other states.

States should also cooperate in the promotion of economic growth throughout the world, especially that of the developing world. The UN Charter, with its focus on sovereign equality and self determination, provides a case against power play amongst states as it prohibits any interference or intervention by states or groups of states in the affairs of other states. In addition, it prevents states from utilising economic or political coercion to influence other states. Rather, states are called to cooperate in matters relating to political or economic matters, with states interacting as equals. In an environment in which economic power is utilised to control world political outcomes, this is a very important provision as it implies that the *status quo* is contrary to international law. While the UN Charter prohibits interference, it does place a duty on states to promote world economic growth, especially the economic growth of the developing world. States, while prevented from power play, must help bring about positive economic outcomes without imposing their will upon the relevant states.

The General Assembly Declaration is an important document as it clearly states the duties of states regarding other states. As a UN declaration, it means that all GATT/WTO Member states are bound by these provisions. Regardless of whether the WTO chooses to explicitly recognise the provisions of the Declaration, these provisions are both relevant and necessary as they provide a foundation upon which WTO states can build and behaviour of states within an economic and political context may be tested.

The United Nations Charter through the equality principle also seeks to promote higher standards of living and conditions of economic and social progress and development.[133] Given that all states are not the same, ie some states are economically more stable and powerful than others, behaviour which does not recognise these differences would appear to be unfair as it would hamper the prospects of smaller, poorer states in achieving economic growth and development. Such a formal definition of equality would be unfair as it would merely perpetuate existing inequalities. A test for fairness would have to take this into account and ensure that existing inequalities amongst Member states are addressed. However the GATT practice is to differentiate between developed and developing economies and to extend, in principle, more beneficial treatment to less developed states.

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133 See section 2.4.2.1.

It can therefore be inferred that this is a value accepted by Member states and that GATT Member states, through differentiation, have gone beyond a formal definition of equality. What is not evident are the principles upon which they base their behaviour. Fairness cannot be determined *ad hoc*, however. While GATT Member states appear to have good intentions with regard to the economic development of developing states, there has to be a blueprint against which behaviour of states can be measured, and which will guide the behaviour of Member states. This is a function which the MFN principle is incapable of performing.

While the MFN principle ensures that developed Member states do not extend more preferential tariff rates to some developed Members which they do not extend to others, it cannot really prevent power play amongst Member states. The focus of the GATT is, at present, an economic one. The neoclassical approach is enshrined in the GATT and offers a thorough justification of private enterprise, *laissez-faire*[134] and international free trade. The liberal perspective states that in a free, competitive market rational consumers will seek to maximise their satisfactions through their purchasing decisions. Rational producers will attempt to maximise their profits by producing more of those goods and services which experience price increases or the formation of queues and reduce production of those commodities with falling prices or growing stockpiles. Basically, the rational producer is responsive to consumer choice. This response will eventually ensure that a society's productive resources are used in the most efficient way. Free trade should, throughout the global market, encourage each society to specialise in those goods and services that they can produce most efficiently. Liberal theory therefore promotes trade based upon comparative advantage.[135]

The GATT is therefore more an expression of liberal theory and seeks to produce greater economic welfare rather than promote fair and equitable outcomes. The condition of a free and open market is one of the conditions upon which markets rest, with formal equity providing a means through which the courts can preserve freedom, thus preventing power play. The liberal perspective and the

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134 The doctrine of unrestricted freedom in commerce, especially for private interests.

135 Jones (1983:172-75).

assumptions of human homogeneity,[136] equal income distribution, perfect information and general absence of barriers to entry, and no negative effects of individual choice on others has been described as being heroic but unrealistic.[137]

Because of its economic focus, the GATT/WTO seeks to achieve efficient outcomes, with equality being one of the conditions necessary for achieving efficient outcomes. A problem with this approach is that it is based upon neoclassical assumptions and does not take into account the reality of the global situation. While states are juridically equal, they are not gifted with the same income distribution. While some countries are resource rich and economically advanced, others are both resource poor and economically challenged. The state of growth of an economy does, however, influence the ability of consumers to maximise their satisfactions through their purchasing decisions as poverty and lack of monetary resources have a real influence on the ability of consumers to choose. The issue of power within the GATT context is also an important factor as the economic growth and development of the more developed economies have given these economies greater negotiating power and therefore, much greater influence. Even in the context of a MFN clause, power still remains an issue because bilateral negotiations between states are power based and do not conform to the call for cooperation by the UN Charter.

Despite the criticisms of the liberal model, there are lessons which can be learned. Without a proper legal foundation which limits and moulds individual behaviour, efficient outcomes are not possible. Rights must therefore be properly defined for a first best outcome to be possible. Without clear separation of rights and limits on the ability of groups seeking to maximise their welfare, power is inevitable and efficient outcomes are much less likely to be achieved. While the GATT seeks efficient outcomes it has not made provision for the legal and legislative processes necessary to ensure negative freedom and secure the protection of rights. While international law provides a basis for fundamental rights amongst states, the GATT has not made provision for a similar rights based

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136 This refers to consumer choice. Humans, or consumers are deemed to be more or less homogenous in their wants and needs. Without such homogeneity expressed demand will be too diverse to facilitate a coherent market system or any kind of modern large scale production system (Jones, op cit note 135 at 176).

137 Jones, op cit note 135 at 176.

approach. In the context of an uneven economic playing field and rampant power play, limits upon the ability of states to pursue their own goals are clearly necessary.

Any policy which enables the indiscriminate sacrifice of states for the purpose of obtaining increased global welfare returns would be unfair. Such a policy is not desirable because it permits the indiscriminate differentiation of states for outcomes which are contrary to both legal and economic principles. From an economic viewpoint, efficiency is linked to behaviour which promotes the increased welfare of all economic sectors. The indiscriminate sacrificial decision-making would therefore be contrary to efficiency requirements. Within the WTO, a definition of equality is necessary which will enable states to address existing inequalities amongst states. Because of the uneven playing field, it is important that a test for unfair discrimination eliminates power play. The approach taken by Rawls on the issue of fairness is appropriate within this context. While Rawls does not advocate an equal distribution of resources amongst individuals, he believes that existing inequalities be acknowledged and that everyone in society be given a fair opportunity of success. To ensure that those who are worse off in society are not exploited by those who are better off, those who are better situated can only extend their fortunes when their efforts improve the fortunes of those who are worse off. Rawls's approach refers, of course, to individuals, but the underlying concepts can be applied to states. If the better off states can improve their fortunes only by improving the fortunes of worse off states, power play becomes difficult as states are called to look beyond their own interests and to act selflessly. The application of this concept will also make redress a real issue amongst states, as states will have to go beyond mere tokenism and truly embrace their obligation to address existing inequalities. A Rawlsian approach will thus ensure that GATT Agreements and processes are substantively fair.

The tests for rationality and proportionality can provide states with a visible means of measuring the fairness of GATT Agreements and WTO procedures. The test for rationality is also necessary to ensure that the WTO is consistently aware of its need to act consciously while the proportionality test will limit the WTO to the most efficient means of obtaining any legitimate goal, thus limiting the harm done to other states. Given the inequalities which exist between states, there is a real need for caution amongst states, as inefficient policies can all too easily reduce the economic growth and

development prospects of vulnerable states, especially the developing economies. The definition of fairness amongst states should be a substantive definition which incorporates the rational connection and proportionality tests. Fair treatment should go beyond same treatment: it should eliminate inequalities amongst states through redress and provide disadvantaged states with fair equality of opportunity. Behaviour which does not provide for the increased economic, growth and development prospects of disadvantaged states would therefore be unfair as it does not address and remove existing inequalities.

2.2.2.4 Redress

WTO Member states have a practice of incorporating elements of redress into trading arrangements. An example of such an arrangement is the Lomé Agreement.[138] Parties to the Lomé Agreement are the former and present European colonial powers and their colonies. The Agreement permits goods of the former colonies to enter the European states at extremely low tariff rates. In addition to Lomé rates, the former colonies benefit from aid agreements and unrivalled access to European markets. The aim of this Agreement, in addition to maintaining trade links between these states, is to build up the economies of the former colonies.[139] While not acknowledged as such, the Lomé Agreement is, in fact, an affirmative action agreement which indicates that the concept of redress amongst states is not an empty one. Similar examples can be seen in the agreements between Japan and the East Asian States and the USA and the Latin American and Caribbean States. Given that so many developed economies have chosen to enter into such relationships with developing economies, it can be argued that states already give rudimentary recognition to this positive aspect of the equality principle. Redress, which is discrimination utilised as a vehicle for remedial action, is necessary to restore balance between groups. It goes beyond mere balance, however: through affirmative action programmes, redress can be used as a means to the end of the more equal society.[140] Redress is an important part of fairness as it enables the relevant authorities to address existing inequalities. It is

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138 See Section 3.4 below.

139 Loc cit.

140 See Section 2.4.1.3.

also essential in promoting fair outcomes, be they economic or legal. Within the context of states, redress is therefore a necessary component of the test for fairness.

2.5 Determining a test for unfair discrimination within the GATT

The concept of equality is fundamental to the upliftment of the disadvantaged and removal of societal inequalities. The effectiveness of the equality principle in achieving the goal of eliminating inequalities and injustice is, however, dependent upon the approach which states adopt. While the formal approach to equality has traditionally been the accepted norm, the law has come to accept that procedural fairness does not necessarily result in substantive fairness or fair outcomes. Placing form above substance often entrenches the very inequalities the equality principle is designed to prevent or eliminate and is therefore not fair. While the law has adopted both a formal and substantive approach towards equality, economic theory, especially welfare economics, is based on a concept of formal equality.

2.5.1 Are the legal and economic approaches reconcilable?

While economics and law have different focuses, the approaches of these disciplines are not irreconcilable. For the economic goal of efficiency to be attained, individuals have to be treated equally. Efficiency is also based upon freedom of individuals to make choices without coercion. The only constraints upon individuals are those which relate to their ability to infringe upon the rights of others. Freedom is only possible in an environment of powerlessness.

The main point of contention between law and neoclassical economics rests on their approach to the equality principle. Neoclassical economics has adopted a formal definition of equality which requires minimal legal intervention in a situation where individuals must be treated equally for the markets to function efficiently. Because the model is based upon an assumption of a level playing field *ie* equal opportunity and access if not equal wealth, no provision is made to address the inequalities which exist at the original position. The law accepts the equality principle but is concerned about the unfair outcomes which accompany a blanket equal treatment provision in

circumstances where the playing field is not level. The definition of equality adopted by the courts is therefore one which reflects the difficulties experienced by society and the focus is on removing those inequalities which can be remedied. Just as, in welfare economics, the general equilibrium theory is a response to the shortcomings of the neoclassical models, so the substantive approach to equality is a progression from the formal approach and provides a depth and responsiveness to the equality provision which the formal approach to equality cannot.

Before equal treatment can become a reality in both economics and law, the inequalities which enable power play must be eliminated. This does not mean a rejection of the ideal of similar treatment but the incorporation of differentiation in circumstances of difference or discrimination. A substantive approach to equality in circumstances of power which is necessary to achieve the goal of powerlessness, should not be rejected. The law has adopted a pragmatic approach in order ultimately to obtain the ideal of equal treatment. Economics, on the other hand, places the achievement of an axiomatic ideal above the pragmatic, which is reflected in the general equilibrium theory. Because the achievement of equal treatment is ideal both in economics and in law, economists should not reject out of hand the approaches to obtain substantively equal treatment. The legal process may provide the freedom and equality necessary for a first best situation to exist. Where the general equilibrium approach provides for the balance of power, the law, through the substantive approach to equality, goes beyond balance of power and focusses on eliminating power through eliminating inequalities which make power possible. The focus on fairness makes the circumstances which are necessary for a first best situation to exist, possible. The tension between law and economics brought about by their different approaches to equality need not therefore exist.

2.5.2 Fairness amongst states

Fairness amongst states cannot be divorced from the issue of fairness amongst individuals. While states are juridical persons and individuals natural, there are some characteristics which are shared by both groups and provide a means of determining fairness amongst states. An approach to equality amongst states must reflect the problems faced by states and the unique circumstances which

characterise interstate interaction. To this end, it is necessary to determine the extent to which relationships between states reflect or differ from those of individuals. The law has adopted a definition amongst individuals which takes into account similarities and differences. Amongst states, there are also differences which exist due to unequal treatment of particular groups and different economic endowment brought about by the unequal allocation of resources and levels of growth. While individuals may rely upon the law to protect them from other individuals, states are reliant upon a much more complicated international system which, because of power play, does not always protect individual states from economic or political infringement of their rights. For individuals, the rule of law is generally clearly defined. Individuals, because they are more aware of their rights and obligations, are more assured of legal protection. This is not a privilege enjoyed by states. Because states are sovereign, many states have been able to rely upon their sovereign privileges to avoid ratifying UN or international conventions. It is therefore much easier for states to act outside of the international system than for individuals. On an individual tenet, differentiation has provided the courts with a means of addressing inequalities. Differences between states have more often than not provided states with a means of avoiding their obligations under international law. While power is a feature of individual relations, there are means of addressing miscarriages of justice linked to abuse of power. Because power amongst states is a common feature in the determining and adoption of international conventions and declarations, it has been much more difficult to guard against. As power plays such an important role in the interaction of states, fair play is more difficult to achieve. Unlike with individual interaction, there is an interdependence among states which determines more than only global policies but which influences the fate of individuals within all states. Without fair play, there are only global losers. The elimination of power play amongst states is therefore of even greater importance than in an individual context.

While the general equilibrium approach provides for the balancing of power, the law, through the substantive approach to equality, goes beyond balance of power and focusses on eliminating power through eliminating inequalities which make power possible. The focus on substantive fairness makes it possible for the circumstances to exist which are necessary for a first best situation. Differing economic endowment and geographic location has resulted in power imbalances amongst states as economic power is a determinant of power on global markets and international

organisations. Just as amongst individuals, the playing field amongst states is uneven. Just as individuals are not responsible for their position at birth, states cannot improve upon their geographic location or resource allocation without infringement of international law. While landlocked states are provided for through the treaty on the law of the sea, such differentiation is very specific and does not harm any other states. The extension of Rawls's difference principle to relations between states is not without merit therefore, as it can be argued that the state within which an individual resides should not provide a barrier to the ability of individuals to grow and improve their economic prospects. The need for states to cooperate where it is necessary to improve the economic growth prospects of fellow states is enshrined in the UN Charter. Where this principle is adopted, it will reduce the ability of states to abuse their positions. A formal approach to equality in such an environment may entrench existing inequalities instead of providing for fair outcomes and the elimination of inequalities. A test for unfair discrimination amongst states should therefore reflect the problems inherent amongst states. A substantive approach to equality, similar to that applicable to individuals, would not be remiss.

It is particularly important that power play be prevented and since power play is linked to economic reforms, economic relations amongst states should be efficient, not utilitarian. In other words, states should not benefit themselves at the expense of other states, and since efficient outcomes result in increased welfare to individual states and the people they represent, increased welfare in turn results in the elimination of power. Power is eliminated through the elimination of these inequalities, through fair discrimination and through redress. A test for unfair discrimination amongst states should therefore incorporate both the requirements of efficiency and the prevention of power.

2.5.3 Conclusions

A test for unfair discrimination amongst states must reflect the characteristics and complexities of interstate relations. Because of the importance of economic progress amongst states, the test should also seek to promote efficient outcomes. The provision of efficient outcomes will be satisfied when all states benefit and any economic interaction which results in one state or group benefiting at the expense of another would be therefore unfair. Because of the uneven playing field, it will be

necessary to place the economic needs of those states who are economically disadvantaged above the needs of those who are economically advanced. This will ensure that the elimination of inequalities amongst states remains a priority and poorer, less developed states are given a fair opportunity to grow. Inequalities cannot truly be removed without redress so there should be a positive obligation on wealthier states to assist in the development of the economically less advantaged states, even to the extent that they sacrifice their goals temporarily. The focus should not, therefore, be on achieving global welfare, even if some states do not benefit, but on ensuring the increased welfare of each state, even if global welfare is not maximised, with the needs of less advantaged states being placed first.

The approach to equality amongst states must take into account the interests of all, both similarities and differences. In the case of similarly situated states, similar treatment is ideal. Similar treatment prevents inequalities between such similarly situated states and maintains the playing field. Similar treatment of similarly situated states provides both equal treatment and fair outcomes. Where similarly situated states are treated differently, this treatment will be deemed discriminatory and unfair unless it can be shown that a rational connection exists between discrimination and a legitimate organisational purpose. In additional to acting rationally, the WTO must show that its actions are proportional.

A rational connection will be seen to exist if the measures adopted are carefully designed to achieve the objective in question. The relevant measures should not be arbitrary or based upon irrational considerations. In the event of treaties or Agreements between states being tested, the same procedure applies, with a rational connection having to be found between the discriminating provisions and a legitimate purpose of the treaty or Agreement. Within the WTO, Member states are collectively responsible for determining the measures to be adopted. The focus of Member states and the focus of the individual Agreements will, however, be different, with the Agreement being linked to the achievement of particular economic goals. The means by which the particular economic goals are to be achieved reflects the will of Member states. For purposes of demonstrating the test, reference will be made for the purpose of the WTO as an organisation.

Where a rational connection can be made, it is also necessary to show that the discriminating measure is proportionate. For proportionality to exist the effects of the discriminating measure and the objective sought to be obtained must be proportional. There must therefore be a relationship of reasonable proportionality between the means employed and the ends sought to be achieved. Proportionality can be determined by balancing the different interests. Consideration should therefore be given to the nature of the right or provision that is limited and its importance to the economic and legal goals of the particular Agreement, organisation or treaty. Particular consideration should be given to the effect of the discriminating treaty to ensure that Member states are treated equally or act without coercion. Relevant consideration should also be given to the reason why the right or measure is limited and the importance of that purpose to the aims of the particular organisation, treaty or Agreement. Consideration should also be given to the extent of the limitation, its effectiveness and where the discriminating provision is necessary, whether the desired ends could not reasonably be achieved through other less damaging means.

The impact of the discrimination upon the group being discriminated against is of particular importance. When considering the impact of discrimination, it must be determined whether the affected group has in the past been discriminated against and whether the discrimination is specific or general. The effect of the discrimination upon affected states is also to be determined. Discrimination is to be deemed unfair if it imposes unnecessary or undue burdens upon the affected groups or unduly prevents these states from enjoying economic or legal rights to which they are entitled. In the case of redress, the discriminating measures are likely to place obligations upon some states which are not placed upon others, or to prevent some states from enjoying privileges which have been extended to others. These effects upon particular states or groups of states are acceptable if they are necessary to remove or reduce power or economic and legal imbalances which exist amongst states and the discriminating measures are necessary to address existing inequalities amongst states. Even in the case of redress, the interests of states should not be unduly harmed. Acceptable outcomes may be deemed to occur where the states place the interests of less advantaged states before their own without seeking to promote their own interest.

The rational connection and proportionality provisions are linked to fairness and efficiency. In the case of discrimination between similarly situated states, it is likely that the introduction of imbalance through dissimilar treatment will be fair or efficient unless the discrimination falls into a category of mere differentiation. Because no imbalance or harm is caused by mere differentiation, the outcome would be both fair and efficient. Where the discrimination results in inequalities between states with some states benefiting at the expense of others, the outcome would be both inefficient and unfair. Such an outcome would have to be avoided because it would place some states in an inferior position to other states, thus allowing power play. In the situation of harmful discrimination, the ability of some states to act free from coercion would be reduced, giving other states greater freedom than the states being discriminated against. Situations which facilitate inequality between states or reduce freedom are to be prevented because they allow for power play. In the case of similarly situated states, discrimination would be unfair unless it can be shown to be mere differentiation, in which case, it must pass the rational connection test. Discrimination which is not proportional and efficient or which results in undue power play amongst states will be unfair, regardless of whether it is rational.

In the case of differently situated states, similar treatment would be unfair unless it can be found to be rational and proportionate and efficient. It will also have to be shown that the similar treatment of dissimilarly situated states does not entrench existing imbalances or inequalities amongst states and abuse of power, resulting in power play or the entrenchment of disadvantage. Where similar treatment maintains the status quo it may still be unfair it there is a duty to benefit states economically or to provide equal opportunities for growth and development. Fairness demands that states are given equal opportunity to succeed. Equal opportunity does not mean that states facing different circumstances must be given the same opportunities however, as redress may be necessary for equal outcomes to be achieved. Where power exists between groups, redress provides a means of addressing power abuse by empowering less advantaged states. This may, however, only really be done by placing the interests of less advantaged states before the interests of the more advantaged states. Formal equality within the context of dissimilarly situated groups makes redress difficult. Such treatment will therefore be unfair.

Where dissimilarly situated states are treated differently, it is still necessary to determine whether the discrimination is rational, proportional, efficient and whether it prevents power abuse. While differentiation is necessary in the context of dissimilarly situated states, it is important that the discrimination is not arbitrary or irrational and that the interests of competing states are balanced. The impact of the discrimination on the group being discriminated against is relevant within these circumstances as discrimination, despite being rational, may not be proportional or efficient. Where the discrimination is rational, proportional, efficient and reduces the abuse of power it will be fair. In circumstances where the discrimination is rational, but does not fulfil the other provisions, it will be unfair.

The test for unfairness or fairness is therefore outcomes based. Rational measures provided for within Agreements, treaties or organisations, whether they provide for similar or discriminatory treatment of states, will be unfair if they are inefficient, disproportionate and do not address inequalities or power amongst states. Measures will also be unfair if they result in inequalities, imbalance and power amongst states.

2.5.4 Practical steps for determining unfair discrimination within GATT

In the chapters that follow various WTO Agreements will be analysed to determine their fairness or unfairness. In doing so, the following questions will be asked:

a) Does the Agreement or provision provide for similar treatment of similarly situated states? If it does, then the question of fairness falls away.

b) Does the Agreement or provision treat similarly situated states differently? If the answer is yes, the question of "mere differentiation" must be addressed. The following questions will then be asked:

   i) is there a rational connection between the differentiation and legitimate objective sought to be achieved? and

   ii) does the differentiation benefit some states without harming others?

Where both answers are yes, then mere differentiation has occurred and the measure is not

discriminatory. Where, however, mere differentiation has not been found, the differentiation is discriminatory and its fairness or unfairness must be assessed. The following questions will then be asked:

iii) are the means employed (in the Agreement or provision) and their effect proportionate to the ends or objective sough to be achieved?

iv) do the means employed seek to promote a situation of powerlessness? and

v) does the differentiation promote efficient outcomes?

Where any of the answers is no, the discrimination will be unfair.

c) Does the Agreement or provision treat differently situated groups similarly? If the answer is yes, then the Agreement is discriminatory, and the fairness or unfairness by asking the following questions:

i) is there a rational connection between the lack of differentiation and a legitimate objective sought to be achieved?

ii) are the means employed (in the Agreement or provision) and their effect proportionate to the ends or objective sought to be achieved?

iii) do the means employed seek to promote a situation of powerlessness?

iv) does the lack of differentiation promote efficient outcomes?

Where any of the answers is no, the Agreement or provision is unfair.

d) Does the Agreement or provision differentiate between dissimilarly situated states? Where differentiation occurs, it is necessary to determine if the differentiation results in less beneficial treatment of affect groups If the answer is yes, then it must be determined whether the differentiation is fair. To determine fairness, the following questions will be asked:

i) is there a rational connection between the differentiation and a legitimate objective sought to be achieved?

ii) are the means employed (in the Agreement or provision) and their effect

proportionate to the ends or objective sought to be achieved?

iii) do the means employed seek to promote a situation of powerlessness? and

iv) does the differentiation promote efficient outcomes?

Where any of the answers is no, the differentiation is unfair.

2.6 Conclusion

The postulated/suggested test for unfair discrimination amongst states incorporates the economic and legal principles of the WTO and is indicative of the dual economic and legal nature of the WTO. While the WTO focus is trade liberalisation and increased gains from trade, the test for unfair discrimination seeks to reflect both the legal and economic realities of diplomatic interaction amongst states. It also seeks to provide states with greater transparency and certainty, while ensuring that negotiations occur within a spirit of respect for the individual rights and needs of the individual states. A focus on the welfare of individual states may also instil within the less powerful, developed states, more confidence in the WTO processes. The focus on powerlessness has been adopted because power often reflects a lack of freedom which stems from inequalities which exist amongst states. In a forum based upon equality, this state of affairs in unacceptable and must be curbed. Lack of legal regulation will enable the more powerful states to pursue their own aims to the detriment of the less powerful, less developed states. If equal treatment is ever to become a viable possibility amongst states, this is a development which cannot be allowed to occur.

Chapter 3

Implications of the reduction of tariffs and non-tariff barriers for developing countries

3.1 Introduction

The Uruguay Round has made extensive inroads in the elimination of non-tariff barriers and the reduction of tariff barriers. Emphasis has also been placed upon the binding[1] of nearly all tariffs, especially by developing countries. The binding of tariffs by developing countries is one of the positive developments of the GATT 1994, despite the fact that tariff levels and protection of the domestic markets of many developing countries remain relatively high. The reduction of tariffs has, however, raised questions amongst some developing countries about access to developed country markets. These questions are linked to the fact that the reduction of most-favoured nation tariff (MFN) rates has reduced or eliminated whatever preferences and, therefore, any advantage which developing countries had over their competitive rivals through the application of the generalised system of preferences (GSP) scheme.[2] In addition, questions about the status of the Cotonou Agreement have raised alarm amongst developing countries, especially those African, Caribbean and Pacific (ACP) countries who are recipients of preferential arrangements with the European Union. Parties to preferential agreements feared that the implementation of the market access results of the Uruguay Round would diminish rather than augment their trade and economic prospects.[3]

This chapter seeks to determine what effect, if any, liberalisation of tariffs and non-tariff barriers in developed and developing countries will have on the market-access prospects of developing country exports into developed country markets and, to some extent, other developing country

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1 When a country binds a tariff on a product at a certain level, it commits itself not to increase the tariff above that level, except by negotiating with affected trading partners and possibly providing compensation.

2 Martin and Winters (1995:IDI).

3 Martin and Winters, op cit note 2.

markets. Before seeking to determine the effects of liberalisation on developing country markets, the tariff and non-tariff barrier reductions which occurred under the Uruguay Round and levels of protection in intra-developed country trade and trade between developed and developing countries will be discussed. The implications of the elimination of the Multifibre Agreement will also be discussed. The chapter will then seek to determine to what extent lower most-favoured nation rates have eroded the preferences given to developing countries with GSP status. Linked to this question is the fate of the ACP countries if the Lomé IV Agreement is phased out completely and countries have to enter into bilateral free-trade agreements with the EU. In addition to determining whether liberalisation has resulted in trade discrimination against developing country exports, the chapter will consider whether the structure of remaining tariff and non-tariff barrier protection enables developed economies to discriminate unfairly against developing economies.

3.2 Results of the Uruguay Round relating to manufactured goods and agricultural products

3.2.1 Tariff bindings

The success of the Uruguay Round rests upon the willingness of all participants to liberate their economies from high tariffs and non-tariff barriers. Not only did participants reduce existing tariffs, they also bound a large number of previously unbound rates. The binding of tariffs is of great significance as it brings some stability to the global trading system, even though some developing countries have bound their tariffs at rates higher than the existing applied tariffs for the relevant goods. Binding of tariffs also plays a role in establishing domestic and international credibility for domestic reform programmes in many countries. Bindings were considered to be so important during negotiations that countries which agreed to bind previously unbound tariffs were given negotiating credit for the decision even where the tariffs were bound at levels above the current applied levels. For industrial products, bindings generally took the form of maximum or ceiling rates for the tariffs applied to the products listed in the schedule of commitments. Tariff levels were not the only commitments which were bound, however. For agricultural products, additional commitments were made on current and minimum market-access opportunities, the value of export

subsidies, volumes exported with the aid of subsidies and on domestic support to agricultural producers.[4]

In the case of industrial tariffs, the percentage of tariff lines bound rose from 78 to 99 percent for developed countries, from 21 to 73 percent for developing countries and from 73 to 98 percent for transition economies. While developing and transition economies do not have as many bound tariff lines as their developed country counterparts, the increase in the coverage of bindings is greater for these groups. This can be seen by looking at the bindings as they occurred regionally. For North America and Latin America the percentage of tariffs bound rose from 99 to 100 percent, and 38 to 100 percent respectively. The percentage of bound tariffs for Western Europe and Central Europe increased from 79 to 82 percent and 63 to 98 percent respectively. For Africa and Asia, the percentage of tariffs bound rose from 13 to 69 percent and 16 to 68 percent respectively. From these figures it is evident that although the developing economies have the lowest percentage of bound tariffs, they have, however, taken a bold step forward in the area of bindings.[5] Despite the changes made by the developing economies, there may be uncertainty about their commitment to policy reforms as their bound rates are much higher than currently applied rates.

3.2.2 Tariffs

Prior to the Uruguay Round negotiations 18 percent of industrial imports from all sources were already entered under MFN tariffs bound at zero. The potential trade coverage of the developed countries' offers was therefore 82 percent of imports. Developed countries agreed to tariff reductions on 64 percent of the value of imports, bindings only for three percent of the value of imports, and made no offer on 16 percent of the value of imports. Most developed country tariffs on industrial goods were already bound prior to the Uruguay Round negotiations.[6] Imports from developing

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4 WTO (1994:25). See also WTO (1998:139).

5 Loc cit.

6 The two leading product groups on which no offer was made are transport equipment with a no-tariff offer on 54 percent of imports into developed countries and leather, rubber, footwear and travel goods which had a "no offer" on 31 percent of imports into developed countries.

country economies into developed countries received the same treatment as imports from all sources, except for products on which the developed countries made no offer. Here developing countries imports did better than imports from all sources, receiving a "no offer" response to only ten percent of their exports to developed countries as opposed to the "no offer" response to 16 percent of exports from all sources.[7]

As a group the developing economies agreed to reduce 46 percent of their tariff lines covering about one third of their industrial imports. No offer was made on 29 percent of tariff lines covering 42 percent of imports. The figures on the share of imports subject to tariff reductions as well as the share of imports on which no offer was made were, however, heavily influenced by the fact that Hong Kong and Singapore did not make offers on a substantial number of tariff lines on which the unbound applied tariff is zero. Together, these countries account for 42 percent of the imports of the 27 developing countries of the Integrated Data Base (IDB).[8] The proportion of dutiable imports into developing countries on which there was no offer was therefore 13 percent. An important aspect of the Uruguay Round tariff negotiations is the heading "bindings without reductions" as this refers to the instances in which tariffs were bound at levels above the currently applied rates. While such bindings were mostly prevalent for developing economies, nine percent of developed country tariff lines, especially those of developed countries in Asia, also fell into this category.[9]

Upon full implementation of the Uruguay Round tariff reductions the proportion of industrial products which enter developed country markets under most favoured-nation zero duties will double from 20 to 44 percent. For developing economies the corresponding change is an increase from 22 to 44 percent. The proportion of imports into developed economies from all sources subject to tariffs above 15 percent will decrease from seven to five percent. The decrease for imports from developing

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7 WTO, op cit note 4 at 8.

8 Information on tariff reductions and imports comes from the GATT Integrated Data Base (IDB). On an aggregate basis, the IDB data covers approximately 98 percent of the merchandise imports (excluding petroleum) of GATT Member states and approximately 90 percent of total world merchandise trade excluding petroleum.
GATT IDB. *www.worldbank.org/research/trade/urdata.html (20 July 2002).*

9 WTO, op cit note 4 at 8-9.

economies is from nine to five percent. When the Uruguay Round tariff negotiations are fully implemented 42 percent of imports entering developing economies will be duty free and 38 percent of the duties will be above 15 percent. The high duty-free tariff percent for developing economies is heavily influenced by the large amount of duty-free imports into Hong Kong and Singapore. For the developed economies, tariffs will be reduced by less than 40 percent for fish and fish products, textiles and clothing, leather, rubber and footwear and transport equipment. Tariffs are to be cut by 60 percent or more for wood, pulp, paper and furniture, metals and non-electric machinery. The percentage of tariff reductions for the four top categories of imports from developing economies, in value terms, is greater for the mix of products imported from developing economies than for the mix imported from all sources. The average reduction of all industrial products is, however, smaller for the mix imported from developing economies (37 percent) than for products from all sources (40 percent). Developed country tariffs above 15 percent will continue to apply to 27 percent of imports of textiles and clothing and 11 percent of imports of leather, rubber, footwear and travel goods. As a consequence of the 40 percent tariff cut on imports of industrial products from all sources, the average tariff on these imports has now fallen from 6.3 to 3.8 percent.[10]

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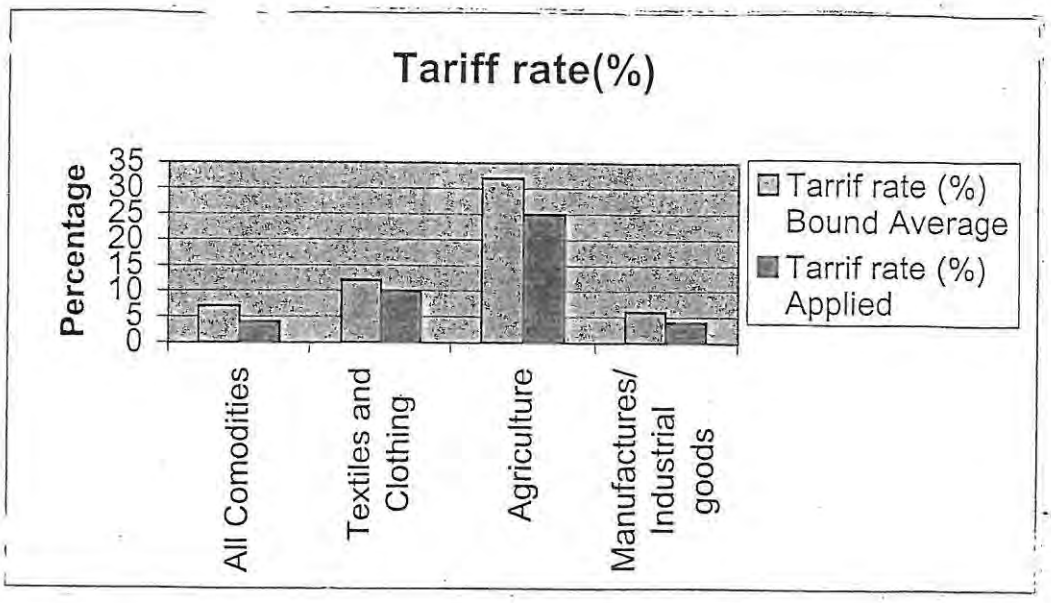
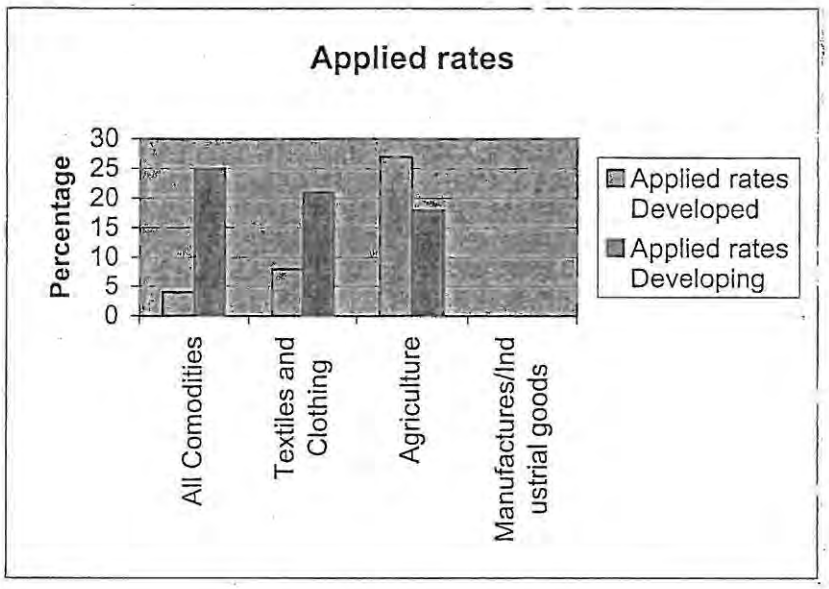
10 WTO, op cit note 4 at 12.

Table 1





The applied tariff rates have also varied considerably across country groupings, with the sub-Saharan African countries having the highest average tariff protection of 19 percent and the Middle East and North Africa having applied average tariff rates of 18 percent.

The average applied tariff of least-developed economies of 18 percent is higher than that of other developing countries (15 percent) and industrial countries (five percent).[11] As a result of tariff reductions, the average post-Uruguay Round tariffs on industrial product imports from most-favoured-nation (MFN) sources for the European Union, the United States of America (USA), Japan

11 World Bank (2001:16). See also Fukasaku (2000:11).

and Canada will range from 1.7 percent for Japan to 4.8 percent for Canada. Tariff reductions amongst developing economies are much less uniform, with the average tariffs on industrial goods ranging from 32.4 percent for India to 5.1 percent for Singapore. The average tariff rates for least-developed economies are however much higher than the tariffs cited above.[12]

While applied average tariffs indicate the overall picture, they do not provide the whole picture as tariff peaks and escalations are masked by these average figures. Tariff peaks are defined as tariffs of 15 percent or higher, or about three times the average tariff level in industrial countries. Tariff escalation occurs when tariffs rise according to the level of a product's processing. In the USA and Canada, more than 85 percent of tariff peaks occur in the manufacturing sector, particularly textiles and clothing, footwear, glass and glass wear, and electrical parts. In the EU and Japan, tariff peaks are concentrated in agriculture and food products, particularly dairy products, vegetables, coffee, tea, cereals, sugar, cocoa, footwear and tobacco. Tariff peak products account for about five percent of total 1999 exports from developing countries to the USA, Canada, the EU and Japan. The least-developed country (LDC) economies have, however, been more adversely affected than developing countries as products subject to tariff peaks represent more than 11 percent of their exports to the EU, USA, Japan and Canada. In Canada and the USA, tariff peaks are found mostly in textiles and clothing, a sector in which more than 90 percent of LDC exports to these countries are concentrated. In the EU and Japan, tariff peak products occur in agriculture, food products and footwear. It therefore appears that in the USA, Canada, the EU and Japan, tariff peaks are concentrated in labour-intensive products of significant export interest to the developing countries and particularly LDCs. Tariff peaks are not limited to industrial countries alone, as the tariff structures of developing countries also contain significant tariff peaks.[13]

As trade between developing countries has increased, so have the barriers faced by developing countries because of the relatively high average tariff rates applied by these countries. While developed country tariffs, except for tariffs on agriculture and textiles and clothing, are now normally

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12 WTO, op cit note 4 at 13.

13 World Bank, op cit note 11 at 19-20. See also Fukusaku (2000:11).

below five percent, with Australia and New Zealand alone having tariffs of around ten percent, tariffs in developing countries are much higher and vary substantially between and within regions. East Asian developing countries impose average applied tariffs of between five and fifteen percent; Latin America, Africa and the Middle East from 10 and 25 percent and South Asia from 10 and 60 percent. Developing countries tend to protect manufactures more heavily than primary products, while (with the exception of textiles and clothing) developed countries tend to protect primary production more heavily than manufactures.[14]

In addition to tariff peaks, there has been tariff escalation in both industrial and developing country protection. This tariff escalation has been of major concern for developing economies. By reducing demand for more processed imports from developing countries, tariff escalation impedes the expansion of their processing industries and, consequently, the means of accumulating skills and capital, and achieving export diversification. The resultant concentration of exports in less-processed commodities often results in slower export growth due to decreased demand for these products in industrial and high-income developing countries, low value-added in production and greater exposure to the risk of commodity price volatility.[15]

Information based on the WTO IDB shows that developed country tariffs, averaged over all industrial products, were subject to tariff escalation prior to the Uruguay Round tariff cuts.[16] While data indicates that tariff escalation is liable to continue in most, but not all instances, the fact that there have been greater absolute reductions in average tariffs at more advanced stages of production than at earlier stages of production suggests that the overall degree of escalation has been reduced and, in a few instances, eliminated. Conclusions drawn from the WTO IDB research have to be approached cautiously, however, as the IDB looks at whole economic sectors whereas tariff escalation refers to precisely defined manufactured chains involving particular products. Data based on tariffs imposed on imports of selected products into Canada, the European Union, Japan and the

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14 Francois, McDonald and Nordström (1995:118).

15 World Bank, op cit note 11 at 22.

16 WTO, op cit note 4 at 14-15. See Table II.5 of the specified article for information on tariff escalation.

USA[17] confirms that there has been an overall decline in tariff escalation. In the case of a few products, however, the decline in intermediate good tariffs has been greater than the decline in final good tariffs. This implies that there has been an increase in tariff escalation at the final stage. The products involved are rubber in the EU, Japan and the USA, jute in Canada, the EU, and the USA, lead in Japan and the USA, zinc in Canada and hides, skins and leather in Japan.[18]

The effect of tariff peaks is to eliminate or reduce the comparative advantage enjoyed by developing countries in areas where developed country exporters are at a disadvantage. Protection of their domestic economies by developed countries occurs at the expense of developing country growth and development. Tariff escalation has the effect of discouraging developing countries from progressing beyond primary industry as their manufacturing sectors are discriminated against. While there appears to be differentiation, such differentiation is merely superficial and masks the discrimination against vital industries and sectors within developing economies by developed countries.

From the structure of post-Uruguay Round tariffs, it is apparent that the reduction of tariffs remains a major goal of the GATT Member states as it is directly linked to market access. Differences between developed and developing country undertakings are indicative of the leeway which has been provided to developing countries, although there appears to be greater pressure on the developing countries to liberalise their economies. Because developed country tariffs were generally low prior to the Uruguay Round, the decreases made in their tariff structures were not as apparent as developing country binding. A development giving cause for concern is the continuing protection against developing country industrial, manufacturing and agricultural exports to developed countries. This is apparent from the structure of developed country tariffs, through both tariff peaks and escalation.

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17 See Appendix Tables 8-11 of the specified reference, WTO, op cit note 4 at 72-75.

18 Loc cit.

3.2.3 Removal of non-tariff barriers on industrial products

On the subject of the removal of non-tariff barriers, the Uruguay Round made two important breakthroughs. Not only did developed Member states agree to the elimination of the Multifibre Arrangement, they also agreed to the adoption of the Agreement on Safeguards. These are considered below.

3.2.3.1 The Agreement on Textiles and Clothing

The Agreement on Textiles and Clothing makes provision for a transitional period during which the textiles and clothing sector will be integrated into the GATT 1994.[19] Unlike other industrial products which have been subject to GATT provisions since its inception, the textiles and clothing sector has been corrupted by the Multifibre Arrangement since early 1974, although the Arrangement has roots going back to the beginning of the 1960s. The Multifibre Arrangement (MFA) divided its 39 participants[20] into two groups, the importers and exporters. The eight importers were Austria, Canada, the European Community, Finland, Norway, the USA, Japan and Switzerland. Of this group, only Japan and Switzerland did not apply explicit restrictions under the MFA. The developing country participants, known as "exporters", were subject to bilateral restraint agreements on their exports to one or more of the importers. Approximately 11 percent of the world's textiles trade and 35 percent of the world's trade in clothing was subject to restraint under the MFA. These figures become 15 and 44 percent respectively if intra-EU trade in textiles and clothing is excluded.[21] Under the MFA, exporters are expected either to purchase a scarce export quota before making an export shipment or pass up an opportunity to sell or otherwise transfer a valuable quota received from the relevant importing government. The effect of these quotas is therefore similar to an export tax levied by the government in the country of origin. The bilateral quotas have generally been more severely binding in the case of wearing apparel, resulting in larger export tax

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19 Article 1(1), WTO, op cit note 4 at 85.

20 Count taken on 1 November 1994.

21 WTO, op cit note 5 at 15-16.

equivalents.[22] For example, Indonesia faces the highest export taxes with rates of 46 percent and 48 percent on wearing apparel exports to North America and Europe. It is followed by China and South Asia who are charged rates of 36 percent and 40 percent for entry into these markets. Korea, Taiwan and Hong Kong face lower export taxes for wearing apparel, a fact which reflects a shift of their comparative advantage away from the production of these products.[23]

Before the Uruguay Round, the countries with the highest concentration of their exports in MFA-constrained items faced the highest weighted average trade barriers in developed country markets. Because the South Asian countries have over 40 percent of their merchandise exports in textiles and wearing apparel, they face the highest import barriers in developed country markets. China has 26.2 percent of its merchandise exports in textiles and clothing while East Asian textile and clothing exports account for only 15.8 percent of total merchandise exports. Other developing economies are much less dependent on textile and apparel exports and can therefore expect very limited gains from the removal of the MFA. This is especially true for developing countries in Africa and the Middle East who have the lowest export share for textiles and clothing and the highest for raw materials. These countries also face the lowest rate of aggregate protection in developed country markets.[24]

The Agreement on Textiles and Clothing provides for the phase-out of MFA restraints in three steps, beginning 1 January 1995 and ending 1 January 2005. This effectively allows for a ten- year transition period. The first stage calls for the integration of products comprising not less than 16 percent of the total volume of each Member's 1990 imports of the products listed in the annexure to the Agreement. The second stage, which begins in year four, requires the integration of a further 17 percent. The third stage, which begins in year eight, requires that another 18 percent of imports be brought under normal GATT rules. Importing countries are free to choose the products they will integrate at each stage, the only constraint being that they encompass products from each of the four groupings: tops and yarn, fabrics, made-up textile products and clothing. At the end of the ten-year

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22 Hertel, Martin, Yanagishima, Dimaranon (1995:75-76).

23 Hertel, Martin et al, op cit note 22 at 78.

24 Blackhurst, Enders and Francois (1995:106). These percentages are based on 1994 figures.

transition period, the remaining 49 percent must be integrated.[25] Products that remain restricted during the transition period are to benefit from a progressively increasing quota. The previously applied MFA quota annual growth rates are to be increased by 16 percent in the first stage, 25 percent in the second stage and 27 percent in the third stage.[26] In some cases the accelerated growth of quotas could render these quotas non-binding before they are formally eliminated. Effectively, however, much of the MFA liberalisation will occur only at the very end of the 10-year phase-in period[27] because this is when the bulk (49 percent) of textiles will be integrated into the MFA. Developed countries can therefore leave integration of sensitive products for last, effectively delaying the positive benefits of integration which could be experienced by developing economies.

Members agreed that it may be necessary during the transition period for them to apply a specific transitional safeguard mechanism, known as the "transitional safeguard" to products covered by the Annexure, except for those integrated into GATT 1994 under Article 2 of the Agreement.[28] Safeguard action may be taken under Article 6 when a Member has demonstrated that a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof to the domestic industry producing like and/or directly competitive products. Such serious damage, or actual threat thereof, must demonstrably be caused by increased quantities in total imports of that product and not by other factors such as technological changes and changes in consumer preference.[29] In determining serious damage or actual threat thereof, Members must examine the effects of the relevant imports on a particular industry, as reflected in changes of economic variables such as output, productivity, utilisation of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investment. None of these factors, either alone or combined with other factors, can necessarily give decisive guidance.[30] In the application

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25 Article 2(8)(a-c), WTO, op cit note 4 at 88. See also Hathaway and Ingco (1995:22).

26 Article 2(14)(a-b), WTO, op cit note 4 at 89.

27 Francois et al, op cit note 14 at 126.

28 Article 6(1), WTO, op cit note 4 at 94.

29 Article 6(2), WTO, op cit note 4 at 94..

30 Article 6(3), WTO, op cit note 4 at 94.

of the transitional safeguards, significantly more favourable treatment must be provided to least-developed country Members, preferably in all its elements but, at least, in overall terms.[31]

Members whose total volume of textile and clothing exports is small compared to the total volume of exports of other Members must be provided with special and more favourable treatment in the fixing of the economic terms provided by paragraphs 8, 13, and 14 of the Agreement on Textiles and Clothing.[32] These exports must account for only a small percentage of total imports of that product to the importing Member however. Exports of wool products from wool-producing developing country Members whose economies and textiles and clothing trade are dependent on the wool sector, whose total textile and clothing exports consist almost exclusively of wool products, and whose volume of textiles and clothing trade is comparatively small in the markets of the importing Members, must also be provided with special consideration. Such consideration must be given to the export needs of these Members when determining quota levels, growth rates and flexibility. More favourable treatment is also to be provided to re-imports by a Member of textile and clothing products which that Member has exported for processing and subsequent re-importation.[33]

Where a Member applies transitional safeguards, these measures may be utilised for up to three years without extension or until the product is integrated into GATT 1994, whichever comes first.[34] If the restraint measure remains in force for more than one year, the level of the restraining measure for the years following must be the level specified in the first year increased by a growth rate of not less than six percent per annum, unless otherwise stated by the Textiles Monitoring Board (TMB).[35] As part of the integration process and with reference to the specific commitments undertaken by Members under the Uruguay Round, all Members have agreed to take such actions which are necessary to abide by GATT 1994 rules and disciplines. The goal for textiles and clothing is

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31 Article 6(6)(a), WTO, op cit note 4 at 94.

32 Article 6, WTO, op cit note 4 at 95.

33 Article 6(6)(c-d), WTO, op cit note 4 at 95-96.

34 Article 6(12), WTO, op cit note 4 at 95-96.

35 Article 6(13), WTO, op cit note 4 at 95-96.

improved access to markets for textile and clothing products through tariff reductions and bindings, reduction or elimination of non-tariff barriers and the facilitation of customs, administrative and licencing formalities. Members seek to ensure the application of policies relating to fair and equitable conditions regarding textiles and clothing in areas such as dumping and anti-dumping rules and procedures, subsidies and countervailing measures, and the protection of intellectual property rights. Members also seek to avoid discrimination against textile and clothing imports when taking measures for general trade policy reasons.[36]

While the developed countries have agreed to the abolition of the MFA, it will not be until after 1 January 2005, when the remaining 49 percent of goods restricted under the MFA are phased out, that the full effects of the abolition of the MFA should really be felt. When this occurs, the countries and regions facing the highest protection on textiles and clothing - Indonesia, China and South Asia - should theoretically be released from their restraints and be able to compete freely in the global market. This will not bode well for developing countries which have been subject to much lower export taxes on textiles and clothing, for example, Korea, Taiwan and Hong Kong, because of a shift in comparative advantage away from the production of these goods.[37] The ACP countries, which have not been subjected to the provisions of the MFA upon entry into the EU market, may also be at a disadvantage as they will not be as protected as they have been in the past and will be open to competition from those countries with a comparative advantage in the production and sale of textiles and clothing.

Given that the textiles sector is traditionally well-protected, the conversion of the MFA to normal tariff protection will undoubtedly continue this protection. The Agreement on Textiles and Clothing facilitates the conversion of non-tariff barriers into equivalent tariff protection. Tariffication does not mean liberalisation, however, as Member states are not obligated to reduce tariffs on textiles and clothing. A number of textile-exporting developing countries, namely Pakistan, the ASEAN Member states, Hong Kong, India and Korea, have already expressed concern about a number of issues relating to the implementation of the Agreement on Textiles and Clothing. These states have

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36 Article 7(1), WTO, op cit note 4 at 99.

37 Herkel, Martin et al, op cit note 22 at 78.

complained that the first phase of integration of the textiles and clothing sector into GATT 1994 has not been commercially meaningful for exporters as, except for one product, all the goods which it has covered had not been restricted under the MFA. Although the Agreement on Textiles and Clothing provides that safeguard measures must be used as sparingly as possible, the USA has invoked a large number of these measures. The USA has also implemented changes in its rules of origin relating to textiles and clothing. This has introduced uncertainty to trade in the textiles and clothing sector. Developing countries have also stated that the functioning of the textiles monitoring body (TMB) should be improved through greater transparency and ensuring impartiality in decision-making.[38]

While there should theoretically be greater access to developed markets for textiles and clothing exports from developing markets, in practice this is not likely to occur as some developed countries have already shown signs of their unwillingness to improve market access in their textiles sectors. The USA, in the initial two stages, has enforced its obligation to integrate 33 percent of its textiles and clothing categories in a way that has eliminated only one percent of its MFA restrictions. The EU has eliminated seven percent and Canada 14 percent.[39] While the Agreement on Textiles and Clothing makes provision for the elimination of the MFA, no specific guidelines have been given for the levels of tariff protection to be adopted. Members have, however, agreed to the reduction of tariffs over time. It can only be assumed that tariffs on textiles and clothing will be on par with or slightly higher than agricultural tariffs. Despite the elimination of quantitative restrictions, suppliers are still likely to be faced with extremely high tariff rates which will erode their competitive advantage in the production of textiles and clothing, forcing them to compete with the less-competitive textiles sectors of the developed economies. Unless the tariffs adopted by developed economies are lowered and safeguard measures are used only when necessary, the elimination of the MFA will initially make little difference to developing economies seeking greater access to developed country markets. Those countries, such as the ACP countries, which have in the past enjoyed preferences in this area will still, however, be better off than countries which have been bound by the MFA.

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38 Petersmann (1997:353).

39 Finger and Schuler (2000:33).

With liberalisation of developed-country markets through the reduction of MFN tariffs, however, ACP countries cannot afford to become complacent. It remains to be seen how open the developed countries will be towards the textiles trade from developing markets. Until developed markets liberalise their textiles and clothing sectors, the biggest result of the elimination of the MFA will be the reshuffling of market share amongst previously disadvantaged developing countries due to changes in competitiveness. As a result of greater competition between developing countries, those countries who were subject to much lower protection may be forced to either become more competitive or shift resources to sectors in which they are more competitive. Until developed economies lower tariffs meaningfully, however, it is unlikely that the developing countries will be able to increase their market share within developed economies dramatically.

3.2.3.2 The Agreement on Safeguards

While the elimination of the Multifibre Arrangement ensures that non-tariff barriers within the textiles and clothing sector are reduced and eliminated, the Agreement on Safeguards, which deals primarily with the regulation of safeguard measures instituted under the GATT 1994, also provides for the reduction and, later, elimination, of other quantitative restrictions within the manufacturing sector. The Agreement provides that Members are to terminate all safeguard measures taken in accordance with Article XIX of GATT 1947 that were in existence on the date of entry into force of the WTO Agreement. Such termination had to occur no later than eight years after the date on which they were first applied or five years after the date of entry into force of the WTO Agreement, whichever comes later.[40]

Members must not seek or take any emergency action on imports of particular products as set forth in Article XIX of GATT 1994 unless such action conforms with the provisions of Article XIX applied in accordance with the Agreement on Safeguards. A Member must not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. An import quota applied as a safeguard measure in conformity with the relevant GATT provisions and the Agreement on Safeguards may, however,

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40 Article 10, WTO, op cit note 4 at 320.

by mutual agreement, be administered by the export Member. Examples of similar measures which are prohibited include export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import licensing schemes as they provide opportunities for domestic market protection.[41] All measures referred to in paragraph 1 of the Agreement on Safeguards must have been phased out or brought into conformity with the Agreement within a period not exceeding four years after the date of entry into force of the WTO Agreement.[42]

Transparency has been a serious problem in the case of so called "grey area" measures. GATT's Trade Policy Review Mechanism has, however, made some progress in identifying such measures in recent years. The Trade Policy Review Mechanism reports which were completed in early 1993 identified 75 bilateral or unilateral restraints. These restraints covered travel goods (14), electrical equipment and appliances (11), footwear (8), television or television tubes (5), machine tools (4) and other products (33). This list did not include non-Multifibre Arrangement quantitative restrictions on textiles and clothing. The number of restraints identified is seen as an underestimate as a number of grey area measures may have escaped notice.[43]

The stricter requirements for the imposition of safeguard measures and the elimination of non-tariff barriers utilised within this context may benefit developing economies, especially those developing economies involved in the manufacture and export of commodities deemed sensitive by developed, and possibly, developing country governments. Given that many grey-area measures may have escaped notice, there is the possibility that states may utilise these restraints to limit access to their markets. The protection provided to developing country exports from protectionist restraints to trade is therefore not complete. Movement away from the use of the most protectionist, efficient restraints may provide developing country exports greater market access into developed country markets as protectionist restraints will have to be applied in a more discreet, overt manner. The Agreement on Safeguards may therefore provide developing country exports greater access to developed country

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41 Article 11(1)(a-b), WTO, op cit note 4 at 320.

42 Article 1(2), WTO, op cit note 4 at 315.

43 WTO, op cit note 4 at 18.

markets. The use of "grey-area" restraints may, however, permit developed states to reduce the competitiveness of imports within domestic markets.

3.3 The effect of lower most-favoured-nation rates upon the Generalised System of Preferences scheme

The MFN tariff rates for manufactured goods have decreased to much more favourable rates for most non-sensitive products since 1994. This has led to fears that the Generalised System of Preferences (GSP), will become ineffective, as the competitive advantage which the GSP gives developing and least-developed economies will be eroded. As greater market access is linked to competitive advantage, this is an issue which is important to the developing countries. The pertinent issue, however, is how realistic these fears are. Advances were made during the Uruguay Round in terms of tariff bindings and applied tariff rates. Negotiations resulted in a bound simple average of seven percent across all merchandise trade and all WTO Members. This figure masks the significant differences across products and countries, however.

3.3.1 Most-Favoured-Nation treatment and the Generalised System of Preferences

Generally, all countries face higher tariffs in developing country markets, which have an overall applied average rate of 12.6 percent. There is, however, greater differentiation in the incidence of tariffs in industrial country markets. In manufacturing, developing countries face an average applied rate of 3.4 percent which is 70 percent higher than the two percent tariff faced by developed countries. In developing country markets, LDCs face tariffs which are about 25 percent higher than those faced by industrial countries. There are no significant differences in the incidence of tariffs for agriculture in developing and developed country markets. The level of agricultural tariffs is, however, much higher than tariffs on manufactured goods - about ten times higher for industrial countries and two and a half times higher for developing countries. In this case it is industrial country agricultural exports, not those of the developing countries, that face the highest tariffs. They face tariffs of 32 percent in developed economies and 31 percent in developing country markets. The least-developed economies are also affected by the incidence of tariffs. For merchandise as a whole,

the LDCs face tariffs 20 percent higher than the world average for access into developed country markets and ten percent lower than the world average into developing country markets. In manufacturing, however, LDCs face higher tariffs than the world average in both developed country markets where tariffs are 30 percent higher and in developing country markets, where tariffs are 20 percent higher.[44]

Although the MFN tariffs do not favour the developing economies, there are preferential schemes such as the GSP which are especially designed to help developing countries sell their products in developed country markets. Preferential access has been set up between developing and developed economies either through unilateral schemes such as the GSP or through bilateral agreements such as the Lomé Convention.[45] About 70 developing countries benefit from GSP or other preferences in one or more of the Quad[46] countries. In the EU, Japan and the USA, the GSP results in a margin of preference of 50 percent or more with respect to the MFN rate, while for Canada the margin is 25 percent. For LDCs the preferences are even greater in Japan and the USA (60 percent) and in Canada (45 percent). Despite the generosity of the GSP margins, they apply mainly to the products which already face relatively low average tariffs of between four to eight percent. With the exception of the EU, the margins of preference on the higher peak tariffs are much lower. The EU's preference margin on peak products is about 51 percent, a figure which compares favourably with the GSP preference margin for all products. The margin for LDCs is 70 percent. Canada's margin of preference on developing countries' tariff peak products is eight percent of the MFN tariff, while Japan has an 18 percent margin of preference on peak products and the USA, 23 percent. For the LDCs, the preference margin for tariff peak products is 25 percent for Canada and 30 percent in Japan and the USA.[47]

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44 World Bank, op cit note 11 at 24-25. For more on the history of the GSP and the evolution of special and differential treatment see Whalley (1999:3-14) and Fukasaku, op cit note 3 at 1-11.

45 Now known as the Cotonou Agreement.

46 USA, Japan, Canada and the EU.

47 World Bank, op cit note 11 at 33-34.

As part of confidence-building measures to enhance LDC participation in international trade, the WTO Director-General has called for the extension of duty-and quota-free access for the exports of LDCs. The Quad countries as well as the Republic of Korea, New Zealand and Norway responded to this call during the year 2000. Canada has included 570 additional tariff lines for duty-free treatment. This accounts for 90 percent of the product categories from the LDCs. Canada will, however, still maintain high tariffs on products such as sugar, wine, textiles, clothing and footwear. The EU Council has adopted the "Everything but Arms" proposal that extends to the LDCs duty-and quota-free access for 919 tariff lines, excluding only the 25 lines related to arms trade. For the sensitive agricultural produce, bananas, rice and sugar, liberalisation will occur more gradually. Duties on bananas will be reduced by 20 percent per annum beginning January 1, 2002 and ending on January 1, 2006. Duties on rice will be reduced by 20 percent on September 1, 2006; by 50 percent on September 1, 2007; by 80 percent on September 1, 2008; and totally eliminated by September 1, 2009. To compensate for the delay in liberalising these products, the EU will extend immediate market access to the LDC by creating duty-free quotas for sugar and rice, based initially on the best figures for LDCs exports during the 1990s plus 15 percent. These quotas will increase by 15 percent each year during the interim period. The EU has also pledged that it will monitor imports of rice, bananas, and sugar and apply safeguard measures if necessary to prevent damaging import surges.[48]

Japan has put into place a system which enables it to designate separately products originating in LDCs for duty-free and quota-free treatment, with the system becoming effective April 1, 2001. This arrangement increased the number of eligible LDCs from 42 to 46 and introduced an expanded list of products to be given preferential treatment. This list includes both industrial and agricultural products which were previously not on the GSP list. Emphasis has however been placed on industrial products, with very few agricultural and food products, for example, rice, being covered. Some of these products remain subject to very high tariffs. The Republic of Korea notified the WTO on April 28, 2000 that it would remove tariffs on 80 items originating from LDCs. New Zealand, on the other hand, has decided to extend duty- and quota-free access to its markets for all products

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48 World Bank, op cit note 11 at 35.

from LDCs with effect from 1 July 2001.[49]

Norway notified the WTO in November 2000 of its decision to extend its GSP system by providing duty-free treatment to all industrial and agricultural imports from LDCs, with the exception of flour, grains, and feeding stuff. The LDCs would be entitled to a 30 percent reduction of the applied customs duty for these products. Following the EU's lead, in April 2000, Norway announced that it would provide duty-and quota-free access for all products from LDCs, beginning 1 July 2002, provided the proposal is adopted by the national legislature. In October 2000 the USA announced that 34 Sub-Saharan African (SSA) countries had been selected as beneficiaries of the African Growth and Opportunity Act (AGOA) and would receive benefits for 1835 tariff lines from December 2000. The African Growth and Opportunity Act extends duty-free and quota-free treatment to imports of nearly all products provided they meet its rules of origin requirements and are imported directly from a beneficiary SSA country. Exceptions include fabrics and yarns not imported as part of a finished apparel product and products determined by the USA Government to be import-sensitive, for example, all agricultural commodities that are subject to a tariff-rate quota. Apparel and clothing have their own preferential regime which includes some flexibility in the rules of origin to utilise regional fabrics.[50] Those SSA countries that are LDCs can export apparel wholly assembled in their countries, irrespective of the origin of the fabric, for a period of four years. Some developing countries, for example Hong Kong, Hungary and the Slovak Republic provide duty- and quota-free access to LDCs.[51]

From the data gathered on the MFN rates and the GSP, it is clear that the GSP rates are a percentage of the MFN national tariff rates. The higher the MFN rates, the greater will be the benefits reaped by the beneficiaries of the GSP. This occurs in two ways. Firstly, higher MFN rates indicate greater overall protection for a product on the world market. Beneficiaries of the GSP, who face lower applied tariffs for these products, would therefore be at a competitive advantage over their rivals

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49 Loc cit.

50 Fabrics not made in the USA.

51 World Bank, op cit note 11 at 35.

who are faced with the higher tariff rates, even though the GSP beneficiaries may be less competitive than their rivals in terms of price. The second benefit is based on the figures. Given that the margin of preference is linked to the MFN rate, a country which enjoys a 50 percent preference on a product with an applied tariff rate of 18 percent is in a better position than one with a 50 percent preference on a product with an applied tariff rate of three percent as competitiveness decreases as the MFN rates falls. As the overall average applied MFN rates have fallen, so has the competitive advantage which beneficiaries of GSP rates have had in the past.

3.3.2 The effect of decreasing preferences on developing economies

While it may seem obvious that decreasing preferences will affect the developing economies, the reality is not as straightforward. It is commonly thought that the GSP protects developing country exports from competition with industrial countries and (to a lesser extent) other developing economies. Figures on the incidence of tariffs in industrial country markets show otherwise.[52] The only deviation in this trend lies in the agricultural sector. Here it is the industrial countries agricultural exports, and not those from developing countries, which face the highest tariffs in other industrial countries (32 percent) and in developing country markets (31 percent).[53]

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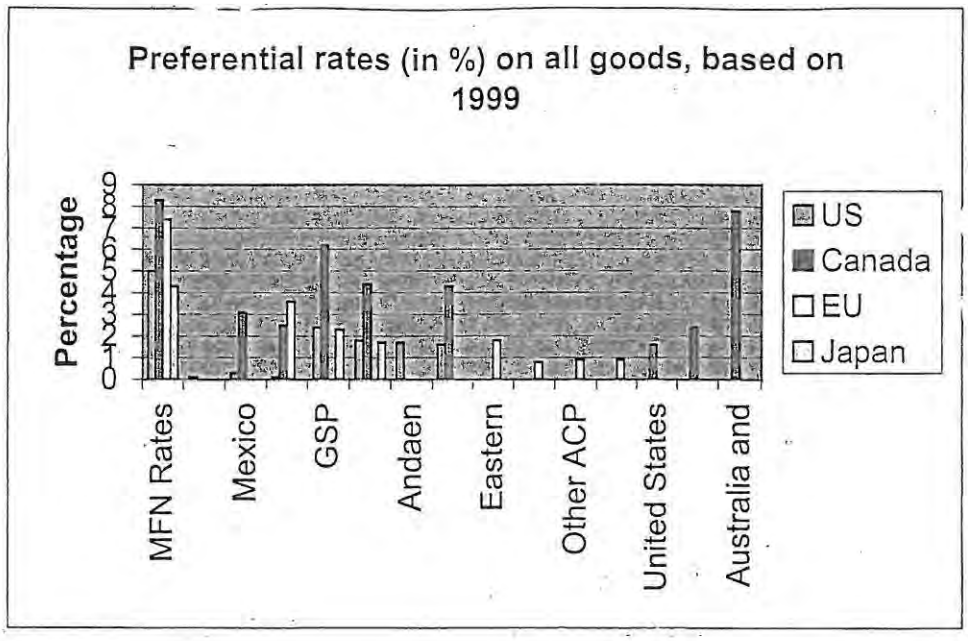
52 See footnote 45. Continuing trade liberalisation on a MFN basis has resulted in significant declines in the benefits derived from trade preferences by the LDCs. Pre-Uruguay Round MFN tariff rates in the European Union, Japan and the United States on the imports of non-oil products from sub-Saharan African countries averaged 4.56 percent and the margin of preferences was estimated at 4.25 percentage points. After the Uruguay Round, these figures fell to 2/68 and 2.47, respectively. This represents a 40 percent decline from the Pre-Uruguay Round situation (Fukasaku, op cit note 13 at 12).

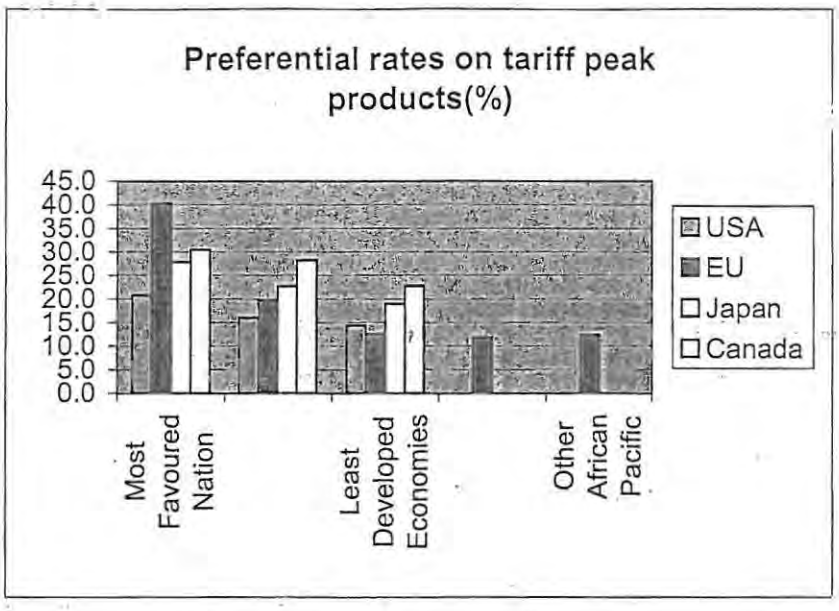
53 World Bank, op cit note 11 at 23-25.

See Table 2 (below)



From the above figures it is clear that the GSP rate has not provided beneficiaries with a real competitive advantage over rivals. Developed country trade appears to receive better access to other developed country markets than the GSP-only beneficiaries, who are also worse off than the least-developed economies. The recent market access initiatives for LDCs will ensure that except for very sensitive products, most developed economies will be according duty-free treatment to exports from LDCs. In the developed-country markets it therefore appears that the GSP rates only provide GSP-only beneficiaries with a competitive advantage over those countries subject to the MFN rates, be they developed or developing economies. As can be seen from the 1999 Canadian figures, the difference between the MFN rate (8.3 percent) and the GSP-rate (6.2 percent), can be very small. Given that these figures do not take into account the non-tariff barriers to which exports from these countries could be subjected, the GSP-rate may not actually provide beneficiaries with any real advantage over their competitors.

Table 3



The preferential rates extended to tariff peak products from GSP-only beneficiaries were not significantly smaller than the MFN rate on the same products. The EU is an exception, however, as the developed economies have extended greater protection against agricultural products from other developed economies than they have against imports of the same products from developing economies. GSP-only beneficiaries therefore have a greater advantage over their rivals in their export of tariff peak products to the EU than they have in the export of sensitive products to the remaining Quad members. It is therefore evident that the decreased MFN rates have reduced the competitive advantage which developing countries who are GSP-beneficiaries have had in the past. It is however also evident that the LDCs have fared better in achieving access to developed country markets than previously thought and the liberalisation which will come through the recent market access initiatives for LDCs will further aid the access of LDCs into developed country markets as well as some developing country markets.

The reduction in the margin of preferences received by developing countries because the reduced MFN rates means that developed and some developing economies will be competing for access to developed and developing country markets on virtually the same terms. Given the trading advantages which developed economies have over their developing country counterparts, for example, the nature

of products, competitiveness facilitated by greater scale economies, etc, greater access to developing countries' markets has been given to developed country exports than to developing country exports. This can also be linked to the structure of protection within developed and developing country markets. Developing countries tend to protect manufacturers more heavily than producers of primary goods. Developed countries, however, are more likely to protect primary producers more heavily than manufacturers, except for textiles and clothing.[54]

Not only do high tariffs in developing countries impede competition from other developing economies, they also discourage intra-developing country trade. This ultimately allows the developed economies, which face lower tariff barriers to trade with developing economies, to achieve greater penetration of developing country markets. Developed countries have a competitive advantage over the developing and least-developed economies due to greater access to capital, skilled employees and know-how as well as research and development capacity, together with greater economies of scale due to greater production capacity. This has placed developing economies with relatively infant manufacturing industries at a disadvantage against the more experienced advanced developing economies and the developed economies in the competitive arena. The implication of tariff protection on sensitive goods for developing economies are serious as the goods most affected by higher tariffs, tariff escalation and tariff peaks are either goods in which developing countries have a comparative advantage, for example, labour intensive agricultural products and textiles and clothing or manufactured products which are in direct competition with developed country goods, for example, lumber, leather, glass wear and glass, electrical appliances. Higher protection of these products in developed markets reduces demand for developing country products, even where these goods are of superior quality and price. Because of the reduced market access for their products, growth of developing markets is discouraged and development of new trading sectors in developing markets stalled as developing country markets are generally too small to provide the necessary capital input, economies of scale or market diversification. While the GSP is meant to provide developing economies with greater access to developed markets from their more developed competitors, increased protection of "sensitive" developed goods undermines the purpose of GSP tariffs. The inability of developing countries and LDCs to penetrate global markets could therefore stunt their

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[54] Francois et al, op cit note 14 at 118.

economic development.

3.3.3 Does the pattern of tariff protection discriminate unfairly against developing economies?

3.3.3.1 The pattern of tariff protection

On a regional basis, Africa and the Middle East have faced the lowest protection against developing countries. This is and has been due to preferential access to the EU and, in other markets, the heavy concentration of Africa's exports on primary commodities, which usually face the lowest tariffs.[55] One half of African country exports to the EU - petroleum and other fuels - are duty-free. The remainder are agricultural and industrial products. The EU has expanded market access opportunities for agricultural products in its Uruguay Round Schedule.[56] In this schedule, the EU has preserved the access for bananas and raised the allocation on sugar from ACP states by six percent to 1,294,900 tonnes. The present EU agricultural regime is likely to raise the income of preferential suppliers for any given level of access due to the tariffication of variable levies.[57] Prior to the Uruguay Round, almost three-quarters of African exports to the EU already entered at rates of less than three percent. This percentage rose to 80 percent after the Uruguay Round. African country exports, both individually and collectively, are mainly concentrated in primary product categories such as metals, minerals, precious stones, or wood products. Even before the Uruguay Round reductions, these products were dutied at 0.4 percent. Sectors of interest to individual countries are fish and fish products, which do not receive preferences, and textiles and clothing, which will be affected by the elimination of the Multifibre Agreement.[58]

Conditions of market access for African exports have also improved in Japan and the USA. The share

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55 Loc cit.

56 Blackhurst et al, op cit note 24 at 107.

57 Blackhurst et al, op cit note 24 at 114.

58 Blackhurst et al, op cit note 24 at 101.

of African exports benefiting from duty-free or low tariff MFN treatment has risen from 55 to 78 percent in Japan and from 82 to 85 percent in the USA. Most products of current export interest such as metals and mineral products are therefore subject to low or duty-free access. While there may be an erosion of preferences on the products from Africa, the fact that the MFN tariffs on these goods are generally very low,[59] means that the overall effect of GSP preference erosion on the market access opportunities of African countries is likely to be insignificant. Next to Africa, Latin America is a region with a large concentration in the production of primary commodities and other industrial products,[60] in addition to agricultural products and textiles and apparel. Tariff rates in industrial products tend to be very low on imports from Latin America.[61] The absolute reduction in protection for Latin America and Africa was therefore much smaller than for Asia because these countries were already enjoying enhanced access to industrialised countries. The reduction in the MFN rates would therefore be much smaller on Latin American exports. As a result, the differences between pre- and post-Uruguay Round MFN rates would be little, making any erosion in the margin between GSP preferences and MFN rates for products exported by Latin American countries very small.[62]

Tariff rates in industrial countries have tended to be highest on imports from the Asian subcontinent, even given the GSP benefits received by these countries, due to the composition of Asian exports. Asian exports have tended to be concentrated either in high peak tariff markets or in high tariff products within industrial categories. As a result, Asian suppliers have faced higher average tariffs in almost every industrial product market.[63] Asian exports have tended to be peak tariff products as

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59 Except for tariffs on textiles and clothing.

60 Exports from Latin America include grain and non-grain crops, livestock, mining, textiles and apparel, steel, petroleum products, chemicals, rubber and plastics, lumber, wood products, pulp and paper, transport equipment and other machinery (Martin and Winters, op cit note 2, Appendix Table 5).

61 De Paiva Abreu (1995:58). This can also be attributed to the special treatment which Latin American countries get from the USA and Canada. Latin American countries were, however, subject to greater protection on agricultural products in the EU and for textiles and apparel, outside of the USA and Canada.

62 Blackhurst et al, op cit note 24 at 106.

63 De Paiva Abreu, op cit note 61.

opposed to "nuisance"[64] tariff products which are linked predominantly to African and to some extent, Latin American exports. The majority of Asian exports comprise manufacturered products, including electronics, and textiles and apparel.[65] Exports also include agricultural products, both raw and processed, for countries such as Korea, Taiwan, Malaysia and the Philippines.[66] In addition to higher tariffs because of tariff peaks and tariff escalation, Asian producers were hindered by the Multifibre Agreement.[67] The elimination of the Agreement is therefore of great significance for textiles and apparel producers in East Asia, South Asia and China as a large percentage of exports from these countries are concentrated in this sector. More than 40 percent of South Asian merchandise exports are in textiles and apparel, with China and East Asia having 26.2 percent and 15.8 percent of their total merchandise exports in textiles and clothing. As a result of the elimination of the Multifibre Agreement, South Asia has experienced the greatest reduction in barriers to trade with protection falling from 25 percent to nine percent, on a weighted average basis.[68]

In order to determine the effect of MFN rates on the Asian economies, it is however necessary to look at their industrial sectors, as these are the sectors in which developing countries receive GSP rates. The Asian economy, despite being home to the advanced developing economies who are subject to MFN rates, is mostly populated by lower and middle income developing economies together with a few least developed economies. Countries within the region were therefore eligible for both GSP and super-GSP rates. Because of the concentration of Asian exports in the area of "sensitive" goods, preferences received by these countries for their manufactured products, especially their consumer products, were most likely to have been peak tariff preferences. Even with liberalisation after the Uruguay Round, MFN rates have remained high on these products, and preferences on these products have been much smaller than preferences on less-sensitive industrial products. Because of minimal

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64 MFN tariffs at or below 3 percent were classified as nuisance tariffs by the Uruguay Round negotiating group on market access. Peak tariffs include the costs associated with meeting the origin requirements for European Free-Trade Association (EFTA) by exporters to the EU (Blackhurst et al, op cit note 24 at 114).

65 Blackhurst et al, op cit note 24 at 106.

66 Hertel, Martin et al, op cit note 22 at 87.

67 De Paiva Abreu, op cit note 61.

68 Blackhurst et al, op cit note 24 at 106.

liberalisation of products in these sectors, Asian countries are more likely to be concerned with the slow improvement of market access opportunities into these sectors than their decreased competitive position because of the erosion of the GSP.

3.3.3.2 Are developing economies unfairly discriminated against?

Articles XXXVI and XXXVII of GATT 1994 provide for special and differential treatment of commodities from developing economies. Article XXXVI (5)[69] states that there is a need for increased access in the largest possible measure to markets under favourable conditions for processed and manufactured products currently or potentially of particular export interest to less-developed contracting parties. To facilitate growth and development of developing country markets, developed contracting parties agreed to give high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to less-developed contracting parties. Reductions would include customs duties and other restrictions which differentiate unreasonably between such products in their primary and in their processed forms.[70] Developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.

The aim of the above provisions is to extend to less-developed countries greater access to developed markets for all their products, especially manufactured and processed goods, as greater market access would encourage the development of secondary and tertiary markets within less-developed markets. Increased growth and development of less-developed markets is to be facilitated by the reduction or elimination of tariffs and non-tariff barriers on developing country commodities.

Developed economies also committed themselves to the reduction or elimination of tariff escalation on goods from developing economies.The provisions for trade and development are an extension of the basic objectives of the GATT Agreement which include the raising of standards of living and the

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69 WTO, op cit note 4 at 534.

70 Article XXXVII (1)(a), WTO, op cit note 4 at 535.

progressive development of the economies of all contracting parties.[71] The contracting parties consider the attainment of these objectives to be particularly urgent for less-developed contracting parties. Developed country commitments stem from recognition by the GATT contracting parties that individual and joint action is essential to further the development of the economies of less-developed contracting parties and to bring about a rapid advance in the standards of living of these countries.[72] The extension of GSP treatment, as opposed to MFN treatment to goods from developing economies, is part of the strategy for increasing growth and development in developing markets and provides the most tangible example of redress within the GATT context.

As the provision of GSP tariff rates to developing countries brings about differences in treatment of developed and developing country goods, there is an obvious recognition of differences between developed and developing economies. In the case of the GSP, the developed economies, while obliged to extend non-reciprocal preferential treatment to their developing country counterparts, are at liberty to decide the depth of the preferences which they can give developing countries. While the provisions for special and differential treatment may appear to impose an enormous burden on developed country markets, the fact that developed countries regulate their own markets means that they are able to limit the negative effects of such preferences on domestic industries.

The provision for special and differential treatment places a positive obligation on the developed states to act in the best interest of the developing states, even where this means putting the interest of developing economies before reciprocal gains from trade. This means that developed economies must discriminate between goods from developed economies and those from developing economies, and provide preferential market access to goods from developing markets. Given the potential negative effects of such discrimination on developed country markets, the question of fairness is raised.

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71 Article XXXVI (1)(a), WTO, op cit note 4 at 533. Contracting parties prior to the formation of the WTO, Member states now.

72 Article XXXVI (1)(d), WTO, op cit note 4 at 533.

Fairness will be determined by looking, first, at whether a rational connection exists between the discrimination and a legitimate GATT purpose. The GSP can be directly linked to Articles XXXVI and XXXVI which are exceptions to Article 1(1) of GATT 1947 and promote special treatment of goods from developing economies as a means of raising the standards of living, promoting the progressive development of developing states and closing the gap between the standards of living in developing and developed economies.[73] The discrimination is therefore not arbitrary but occurs within the context of a legitimate GATT purpose. A rational connection therefore exists between the discrimination and a legitimate GATT purpose.

While a rational connection can be established between the discrimination and a legitimate purpose, is the discrimination proportional, that is, do the means employed justify the ends sought to be secured? Through the analysis of the GSP, it will be established if the increased access to developed markets actually furthers the growth and development of developing markets. Article XXXVII obliges developed states to eliminate or reduce unnecessary protection against developing country commodities, thereby increasing access of manufactured and processed goods into developed markets. Many developing economies are still reliant on primary, unprocessed, goods[74] for most of their foreign earnings and have not established viable competitive manufacturing sectors. The progression from primary products to manufacturing is important for the development of developing markets as it results in greater monetary returns because of the increased value which is added to primary goods. Where, on the other hand, developing economies have a comparative advantage in the production of labour-intensive agricultural products greater market access is to be provided for these products as well. A major component of the GSP is that the opening of markets has been, prior to the liberalisation commitments of developing economies during the Uruguary Round negotiations, one-sided. While the developed economies extend preferential treatment to developing economies through the GSP and other preferential market access schemes, developing country markets have remained highly protected.

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73 Article XXXVI (1)(c), WTO, op cit note 4 at 533.

74 See section 3.3.3.2.

This one-sided approach can be justified by the fact that without preferential access to developed country markets, commodities from developing economies would have to compete on the same terms with developed country commodities which, due to greater economies of scale, technological know-how, product ranges, familiarity etc, would have had a greater competitive edge. Preferential access provides developing country goods with an edge which enables manufacturers to establish more competitive, productive industries. While the special and differential treatment provision gives a greater competitive advantage to developing country manufacturers, this advantage is justifiable as the growth and development which discrimination facilitate within developing markets overshadows any harm which would be felt by developed country industries. This is an opinion shared by Fukasaku who states that the benefits of privileged market access have been concentrated in only a few countries and a few products. The GSP schemes also suffer from many complex procedural requirements with respect to the rules of origin, quotas and ceilings. In addition, the exclusion of many sensitive products leads to a mismatch between the exports of beneficiaries and the coverage of preferences. As a result, the benefits derived from special and differential treatment are not as far-reaching or beneficial to the developing economies as they may appear to be.[75]

Greater market access for developing country goods has a positive effect however, as, in the case of the production of labour intensive products, developing countries tend to enjoy a comparative advantage over their developed country counterparts, whose advantage lies in the production of capital intensive goods. By opening their markets to goods in which developing economies have a comparative advantage, both developed country consumers and developing country producers benefit as greater liberalisation of developed markets leads to increased gains from trade for both consumers and producers. While greater competition from developing country producers of labour-intensive products may result in short-term losses for non-competitive developed country producers, competition may be a necessary catalyst for the movement of resources into more competitive developed country industries. Without preferential access of developing country commodities into developed country markets, however, it is doubtful whether progressive development of developing country markets will be as readily achieved. In this instance, the means justify the ends sought.

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75 Fukasaku, op cit note 13 at 14.

While Articles XXXVI and XXXVII have called for greater market access for all developing country goods, the GSP does not fully comply. The developed economies, as discussed earlier, have maintained high tariff and non-tariff barrier protection on sensitive labour intensive goods such as agricultural products, textiles and clothing, electronic goods, leather, footwear, glass and glass wear, which are prevalent mostly in developing countries. While tariff escalation has decreased, it has not totally been eliminated and can still be found on tariff peak products. Products in which the developing countries have a comparative advantage are still subject to greater protection than other products, a development which does not contribute towards the development of secondary industries within developing markets. Where fairness dictates that developed economies adopt policies which promote redress, the protection of domestic goods against competition from cheaper developing country exports does not promote redress but further entrenches the dominance of developed country industries on global markets. A case in point is the liberalisation of the textiles and clothing sectors.

While non-tariff barrier protection has been converted into tariff protection, developed countries have maintained extremely high levels of tariff protection against textiles and clothing from developing economies. Because textiles and clothing make up a greater part of exports from some developing countries, protection hinders the growth of these countries. Until developed markets reduce protection against goods which they claim are sensitive and give the developing countries a real chance to compete against their non-competitive sectors, they will not have begun to fulfil their positive obligation to aid developing economies. Preferences which extend to primary and non-sensitive goods do not count because tariffs on these goods are already very low or non-existent. A point made earlier in the chapter is that developed country products, except for agricultural products, enjoy greater access into other developed country markets than developing country goods. Given that developed countries are the biggest competitors of developing country manufacturers, especially in the case of secondary industrial products, the preferential access extended to developing economies does not provide developing economies with the competitive edge which it is supposed to. The GSP, as applied at present, does not pass the legal test for efficiency as it does not provide for true redress. Where it really matters, the developed economies have maintained protection of domestic markets, placing concerns about non-competitive industries above the needs of developing country development.

From an economic standpoint, greater liberalisation of markets is necessary for gains from trade to be realised. Because comparative advantage is dynamic, competition facilitates a movement away from industries in which countries have no comparative advantage to industries in which countries have a comparative advantage. The protection of non-competitive, labour-intensive industries in developed markets is not efficient as it inhibits the free movement of goods from sectors with no comparative advantage to those areas with comparative advantage. By protecting their labour-intensive sectors from more competitive imports, developed economies not only inhibit the development of these sectors in developing economies but also transfer resources from areas in which they would be more effective to inefficient industries. An example is the protection of agricultural products in the USA and the EU. By subsidising domestic production, the USA and EU are effectively undermining the agricultural sectors of developing economies and robbing their consumers of the benefits which they would derive from liberalised agricultural sectors. Even where developed country products are cheaper than imports, consumers are effectively carrying the cost of subsidisation. Greater protection by developed economies of sectors in which developing economies have more competitive exports effectively reduces gains from trade. In addition, consumers from developed countries and producers in developing economies lose. Such protection cannot be deemed economically efficient as it enables developed country producers to gain at the expense of developing country producers and developed country consumers.

An important point that can be gleaned from the above and previous discussions within this chapter is that the GSP does not result in powerlessness amongst states. By protecting their markets from competitive developing country exports, the developed country governments are hindering the growth and development prospects of developing countries in the affected areas. More importantly, the fact that developed country governments can protect their markets in conditions where they are obliged not to do so means that the power imbalance between these states has not been addressed and the inequalities which contribute to the abuse of power remain. While the GSP obliged developed states to give preferential access to developing country exports at all areas of development, the extent of liberalisation was left to the developed economies. Developing economies, apart from the non-reciprocity provision, remain at the mercy of developed economy charity. As a result, a provision which was meant to empower developing economies has actually resulted in superficial commitment. Discrimination, within this context, cannot be deemed fair because it does not provide efficient

outcomes or promote powerlessness in global markets.

3.4 The future of Cotonou

3.4.1 The significance of Cotonou

The Cotonou Agreement has been another avenue whereby a select group of developing countries, the African Caribbean Pacific (ACP) countries, previously colonial territories of various European States, have been able to benefit from continued preferential treatment and greater market access to the European Union. Cotonou (previously Lomé) began with French policies towards its ex-colonies in Africa, the accession of Britain to the EEC in 1972 and the New International Economic Order of the 1970s. The basic characteristics of Cotonou are equality between partners, respect for their sovereignty, and security of the relationship based on these mutual rights and obligations.[76] Parties to the Agreement remain committed to the Cotonou partnership which began in 1975. Despite the fact that Cotonou is an example of a successful collaboration between North and South and has set an example for future North-South partnerships, many criticisms have been laid against the Agreement. Critics point out that many ACP countries belong now, as they did twenty-five years ago, to the group of least-developed economies. Basic human needs, such as food, housing and medical care are not guaranteed in all ACP countries. The development of trade between the ACP and the EU remains unsatisfactory.[77]

Despite the criticisms levelled against the effectiveness of the Cotonou Agreement, the mere fact that more than 80 countries, nearly half the independent countries of the world, are working peacefully together on a contractual basis is considered an important step forward. Parties also state that ACP-EU relations need to be measured in terms of economic and social development. The results of the

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76 McQueen (1998:423). For in-depth reading on the history and scope of Lomé, see Ravenhill, (1985), and Boardman, Shaw and Soldatos (1985). The Cotonou Agreement of 2000 has effectively rolled over the Lomé IV provisions until 2007 and replaced the Lomé Agreements. While the Agreement will be referred to as Cotonou, where reference is made to the previous Agreement the name Lomé will be used.

77 Edwards and Regelsberger (1990:47).

Cotonou Agreement are also compared with its own aims and basic principles, namely interdependence, mutual interest, respect for the sovereignty of each party, non-discrimination between beneficiaries and guaranteed and reliable aid.[78] For the ACP countries the trade concessions and aid provisions offered by the Cotonou Agreement are an important attraction, as is the link which the convention provides them to the lucrative EU market. Cotonou's central trade provision is the granting of duty-free access to the EU market for most ACP exports. In keeping with the GATT provisions for special and differential treatment for developing economies, the ACP countries are not expected to grant corresponding preferences to the European countries.[79]

There were previously two main limitations. The first was that agricultural products which compete with EU products falling under the Common Agricultural Policy (CAP) were not granted free access to the Community. While the ACP countries had preferential access over non-ACP countries, they did not have uncontrolled access. Examples of varied terms of access can be found in the three protocols for sugar, rum and bananas which are attached to the Cotonou Agreement.[80] The ACP countries were also limited by rules of origin criteria which establish the minimum local content requirement. Products were allowed duty-free access to the EU only if one-third of their value originates from an ACP country. These rules sought to prevent non-ACP countries from diverting their exports to the ACP states so that they could take advantage of the duty-free access afforded to these countries. This provision has, however, raised a number of problems for the ACP countries. Firstly, it prevents them from establishing simple export-oriented assembly operations, if the goods to be assembled originate in non-ACP countries. Secondly, in the case of textiles, EU rules stipulate that although yarn may come from non-ACP sources, cloth must come from ACP sources.[81]

All products originating in ACP countries were later imported into the EU free of customs duties and charges having equivalent effect. The EU is now also bound not to apply any quantitative restrictions

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78 Edwards and Regelsberger, loc cit note 77.

79 Article XXXVI (8), WTO, op cit note 4 at 534.

80 Ravenhill (1985:219-251).

81 Coote (1992:124-25).

or measures having equivalent effect to imports of products originating in ACP countries. The only exception to this legally-binding guarantee of free entry concerns products subject to the restrictions of the common agricultural policy (CAP). The concessions on CAP products include combinations of:

a) reductions (up to 100 percent) in customs duties which may be *ad valorem*, specific, or both;
b) reductions in customs duties subject to tariff quotas or reference quantities;
c) concessions on minimum entry prices; and/or
d) concessions on entry prices subject to tariff quotas or reference quantities.[82]

The ACP countries can also request preferences on new lines of agricultural production or agricultural products. With regard to rules of origin, the ACP are better situated than other countries as they can cumulate origin both between themselves and by using imports from the EU. The ability to cumulate origin is only available to non-ACP countries on a limited basis. The ability to cumulate origin by using imports from the EU is, however, available in all of the EU's preferential trade agreements. The ACP countries can also request a derogation from the rules of origin, with decisions being made by the joint ACP-EU Customs Co-operations Committee. A derogation is automatically granted where the value added is 45 percent. The ACP countries also benefit from a concession which enables non-originating materials of 15 percent of the ex-works prices of the product to be used in production. The safeguard clause is also less restrictive than the EU's other preferential arrangements as it refers only to serious disturbances in a sector of the economy of the EU or one or more of the Member states.

Where limitations are to be placed on the use of the safeguard clause, prior consultation must take place with the ACP states concerned and the Council of Ministers. Particular attention is to be paid to the interests of the least-developed, landlocked and island ACP states. ACP exporters of sugar, beef and veal, rum and bananas benefit from the protocols providing preferential access. The EU has undertaken to import from thirteen ACP countries, for an indefinite period, specified quantities of cane sugar at guaranteed prices which are related to the CAP support price. The EU will import

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82 McQueen, op cit note 76 at 423-34.

1,294,700 tonnes of sugar divided between the thirteen ACP states. In addition, the ACP countries benefit under a separate arrangement from an annual special tariff quota at a preferential import duty of 69 ecu per tonne, for a maximum of 474,300 tonnes.[83]

Prices received by ACP sugar exporters to the EU have been twice to three times the world price since the early 1980s and have been a particularly important source of export earnings for countries such as Fiji, Guyana, Jamaica, Mauritius and Swaziland. While beef and veal exporters also receive a substantial margin of preference, they have experienced difficulties in filling their quotas. Despite the various concessions made to the ACP countries there has been limited growth and diversification of ACP exports. Since 1975 the ACP's share of EU non-oil imports from developing countries has halved. This cannot be seen as a failure of Cotonou, however, as the makeup of ACP exports to the EU has not been conducive to growth and development. ACP exports have been concentrated in predominantly primary products which are subject to low income elasticities of demand and low growth rates. They have also been subjected to declining and unstable export prices over the past decade and to small or zero margins of preference. ACP exports are also heavily concentrated in a few products exported by a small group of countries. For the period 1991-1995 Nigeria accounted for 22 percent of ACP exports to the EU. For the same period, 11 ACP countries accounted for 47 percent of ACP exports to the EU. The ACP countries have, however, capitalized on some of the preferences received. Data on non-traditional ACP exports to the EU has indicated that non-traditional exports have increased from very low levels in 1975 to 13.5 percent of exports in 1994. Most of these products were in fisheries, clothing and fruit and vegetables, areas in which the ACP countries have both a comparative advantage and a significant margin of preference over non-ACP countries. While the relatively more developed ACP countries have played a dominant role in the area of non-traditional exports, growth has also occurred in the less-developed economies of Burkina Faso, Mali, Tanzania and Madagascar.[84]

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83 McQueen, op cit note 76 at 425.

84 McQueen, op cit note 76 at 426. The progress of ACP states can be linked to the level of development achieved by individual states. While the developing states are often portrayed as a homogenous group, the issues discussed by states within the context of Cotonou and the problems experienced by states can be partly attributed to the varying levels of development achieved by these states.

Given the reduction of the MFN rate with increased global trade liberalisation, it is important to consider how important and relevant the Cotonou preferences are to the ACP countries. While a large volume of ACP exports to the EU are concentrated in primary non-processed products and therefore subject to duty-free entry into the EU, there remains an increasing sector of trade made up of agricultural and non-traditional exports which enjoys greater access into the EU market than corresponding exports from non-ACP sources. Whereas the MFN rate on all goods exported to the EU is 7.4 percent, least-developed ACP countries are subject to a 0.7 percent tariff and other ACP countries are subject to an 0.8 percent tariff. For sensitive or tariff peak products the MFN rate is 40.3 percent. Least-developed ACP countries and other ACP countries are, on the other hand, subject to a tariff rate of 11.9 and 12.4 percent for tariff peak products.[85] Although the MFN rates for non-sensitive goods have dropped, the ACP rates remain relevant. It is in the area of sensitive goods or tariff peak products, however, that the Cotonou preferences have been of particular importance to the ACP countries as they have given the ACP countries a much greater advantage over competitors, developing and developed countries alike. Access to preferential treatment on sensitive goods is not secure, however, as the dismantling of the Multifibre Arrangement may soon deprive the ACP countries of preferential access and the corresponding advantage which they have had over developing country competitors in the export of textiles to the EU. The EU's preferential import regime for bananas has also been successively challenged, with the GATT dispute settlement panels ruling in favour of the Latin American complainants. In their judgment the GATT Panel stated that Article XXIV or Article XXIV in conjunction with Part IV (trade and development) could not be used as a defence for discriminatory treatment of non-ACP countries.[86] The Panel found against the EU banana import regime on the specific grounds that the preamble to the Lomé waiver required that the preferential treatment required of the convention should not raise undue difficulties for the trade of other countries. The EU's import licensing procedures for bananas did create undue difficulty, however, as the Lomé Convention did not specifically require that the EU adopt the licencing procedures and other WTO-compatible measures in fulfilling its obligations to the ACP States.[87]

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85 World Bank, op cit note 11 at 33.

86 McQueen, op cit note 76 at 429.

87 McQueen, op cit note 76 at 430.

In addition to trade preferences, relief from stringent safeguard measures and derogations from rules of origin, Cotonou is committed to providing aid, technical assistance and policy dialogue and the co-ordination of these elements to promote economic growth and development. In practice, however, Cotonou has failed to provide this co-ordination. While relatively generous trade preferences have been provided to the ACP countries, little attention has been given to overcoming supply constraints and enabling the ACP countries to take advantage of their access to the EU market. Cotonou also needs to be better co-ordinated and more transparent with fewer instruments, and focused on activities which are complementary to the activities of the Member states. The rules of origin have also been criticised as not taking account of the low level of industrialisation of most ACP states and the world-wide sourcing requirements of modern production. While the ACP countries benefit from their close association with the EU, maintenance of the *status quo* may prevent ACP countries with weak macroeconomic and trade policies from upgrading and adopting more relevant policies. The ACP-EU link may also prevent the ACP countries from taking advantage of the possibilities offered by global trade liberalisation.[88]

3.4.2 Options available to the ACP countries

Irrespective of the merits and demerits of the ACP-EU convention, its future hangs in the balance. With the expiry of Lomé IV in February 2000 the ACP countries stood to lose their special access provisions to the EU. The Cotonou Agreement, signed in June 2000, has effectively rolled over the Lomé IV trade provisions until 2007, with the proviso that this period be used to negotiate a more secure successor regime.[89]

The Lomé Conventions were allowed under an Article XXV(5) waiver under the GATT 1947. The first Lomé waiver was obtained in accordance with the "grandfather provisions" of Article I(2) and (3) of GATT 1947 which allowed for preferences between ex-colonies and ex-colonial powers. As such, preferences did not have to be general and apply to all developing countries. This provision allowed contracting parties to waive obligations imposed upon them by the GATT, provided that any

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88 McQueen, op cit note 76 at 428.

89 Stevens and Kennan (2000:5). See also Graumans (1997) and Lambrechts (1991).

such decision be approved by a two-thirds majority of the votes cast and that such a majority comprise more than half of the contracting parties.[90] The EU subsequently sought to obtain a new waiver for the Cotonou Agreement. This application, while initially opposed by non-ACP developing countries was granted at Doha, where a new round of multilateral talks is being held. While the new waiver has now been obtained, the issues surrounding this waiver will be discussed together with the options available to the ACP-EU contingent had the new waiver not been granted.

Unlike the Article XXV(5) conditions for allowing a waiver, the new WTO Article IX provisions for seeking a waiver are more stringent. Article IX(3) states that in exceptional circumstances the Ministerial Conference[91] may decide to waive an obligation imposed on a Member by the GATT 1994 or any of the Multilateral Trade Agreements, provided that any such decision shall be taken by three-quarters of the Members unless otherwise provided for in Article IX(3). A decision by the Ministerial Conference granting a waiver must state the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver and the date on which the waiver will terminate. Any waiver granted for a period of more than one year will be reviewed by the Ministerial Conference no later than a year after it is granted and thereafter annually until the waiver terminates. In each review, the Ministerial Conference will examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met. On the basis of an annual review the Ministerial Conference may therefore extend, modify or terminate the waiver.[92] Nearly three-quarters of the WTO Members are developing countries. Given that rival non-ACP developing countries had objected to a waiver unless concessions are made for the entry of their sensitive agricultural and other products into the EU, obtaining a waiver in terms Article XXV(5) may not have been as simple as it was prior to the adoption of the GATT 1994.

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90 WTO, op cit note 4 at 525.

91 Article IV(1) of GATT 1994 provides that the Ministerial Conference of representatives of all the Members which shall meet at least once every two years. The WTO has adopted the practice of decision-making by consensus followed under GATT 1947. Where a decision cannot be arrived at by consensus, the matter shall be decided by voting. Decisions of the Ministerial Conference shall be taken by a majority of the votes cast unless otherwise provided for in the GATT 1994 or in the relevant Multilateral Trade Agreement. WTO, op cit note 4 at 8.11.

92 WTO, op cit note 4 at 11 and 12.

Until a second waiver to the GATT/WTO provisions could be obtained, the preferences and other benefits enjoyed by the ACP countries were relatively unstable. The basic problem facing the EU in obtaining a new waiver was that while the EU's preferential accords are by definition discriminatory, the fundamental WTO policy of non-discrimination was being more closely monitored by Members. The main difficulty for preferential agreements with the adoption of the WTO was more one of attitude rather than legal detail. The introduction of the dispute-settlement body has led to increased litigiousness. Aggrieved parties are now more willing to challenge practices to which they object, be they preferential accords or other aspects of trade policy. As a result, North-South preferences appear to be more vulnerable to attack. To secure its preferences, the EU would have had to bring its policies more in line with WTO policy.[93]

The EU decision to seek a waiver for Cotonou from Article 1(1) under the provisions of Article XXV has therefore been the result of a change in the climate of opinion on departures from GATT rather than due to changes in WTO rules. This decision was made in order to provide Cotonou with greater legal security. The 1997 panel on bananas has helped clarify the exemptions from WTO rules offered by a waiver.[94] In its submissions the EU claimed, among other things, that the waiver permitted preferential treatment for the import of bananas from the ACP states and that the waiver from Article 1(1) also applied to other GATT provisions requiring MFN obligations. Reference was made to Article XIII(1) which concerns non-discrimination in the administration of quantitative restrictions. The panel endorsed the EU's claim, stating that the waiver applied to preferential treatment in general and was not, as in the case of other waivers, confined to preferential tariff treatment. As the EU's Cotonou's obligations could not be fulfilled simply on the basis of tariff preferences alone, the EU was justified in its use of country-specific tariff quota shares up to the amounts necessary to fulfil its obligations. The Panel found against the EU banana import regime, however, on the specific grounds that the preamble to the Lomé waiver stated that the preferential treatment required by the Convention should not raise undue difficulties for the trade of other countries. The import licensing procedures for bananas were inconsistent with its obligations under Articles 1(1), III(4), X(3) XIII(1)

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93 Stevens and Kennan, op cit note 89 at 10.

94 *European Communities - Regime for the Importation, Sale and Distribution of Bananas, Report of the Appellate Body*, WT/DS27/AB/R (9 September 1997).

of GATT, Article 1(2) of the Licensing Agreement and Article II and XVII of the General Agreement on Trade in Services (GATS). The Panel's judgment did not challenge the Lomé preferences *per se.* It merely emphasised that the waiver and any future waiver must be clearly defined and narrowly interpreted to allow only measures specifically required by the Convention and covered by the precise terms of the waiver.[95]

The *Bananas* case has demonstrated the importance of a second Cotonou waiver being much more carefully and precisely drafted than the first waiver. McQueen states that to provide for a solid and complete legal defence for discriminatory preferential treatment, the waiver needed to specify exactly which sections of the agreement need to be covered and precisely which WTO obligations needed to be waived. Only a carefully constructed waiver, accepted by consensus, could provide the ACP countries with legally secure preferences.[96] The biggest obstacle would have been convincing all WTO Members to vote in favour of the waiver which would require the EU to make concessions to middle-income developing countries seeking preferential access to the EU markets for sensitive goods. This is the group of developing countries most likely to provide opposition, especially the Latin American countries who are in direct competition with the ACP countries for greater access of their bananas into the EU market.

The EU would probably have had to adopt policies which benefited these aggrieved states without eroding ACP preferences. Stevens and Kennan[97] suggest that the introduction of the element of contractuality into the GSP would represent a tangible gain for the aggrieved states without eroding ACP preference margins. A problem faced by GSP recipients in the past has been the changeable nature of the GSP. This has occurred because the EU GSP is a wholly autonomous policy and can therefore be changed at will without notice at any time. This has been a flaw in the quality of the market access obtained by standard and super GSP beneficiaries. Stevens and Kennan suggest that stability can be brought to the GSP through bindings in the WTO or an extra-GSP contract. Binding GSP rates in the WTO would represent an advance on the Cotonou Agreement. Until now, however,

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95 McQueen, op cit note 76 at 430-31.

96 McQueen, op cit note 76 at 431.

97 Stevens and Kennan, op cit note 89 at 29.

the only tariff rates bound in the WTO/GATT have been MFN ones. In order for GSP rates to be bound, WTO procedure would have to be changed to allow for the possibility of multiple rates being bound. The EU would also have to accept the loss of freedom which the autonomous nature of the GSP currently provides. The Ruggiero Initiative for the binding of GSP tariffs for least-developed countries has provided room for negotiating the binding of other GSP rates. While the EU has indicated a willingness to bind GSP rates for least-developed economies, the political acceptability of extending bindings to other groups would be influenced by the EU's longer-term plans for the scheme.[98]

On the issue of an extra-GSP contract, Stevens and Kennan refer to the EU's long history of concluding trade and cooperation agreements in which there are no specific provisions for tariff treatment, and in which the actual regime faced by exporters to the EU is determined by the GSP. To the extent that the trade and cooperation agreements moved beyond politics, they included other provisions which supplemented the tariff treatment of the GSP. Stevens and Kennan suggest that while the EU GSP is an autonomous policy, there appears to be no reason in principle why the EU cannot bind itself in a framework agreement to forego its autonomy in relation to specific trade partners.[99]

Another way in which the middle-income developed countries could be accommodated is through improved access for specific products. This could be done by identifying products for which the gain for potential opponents of the new EU-ACP trade accord would be great but losses for the ACP would be tolerable by virtue of their competitive situation and/or the likely erosion of preferences

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98 Stevens and Kennan, op cit note 89 at 30. The EU extends general GSP rates to GSP-only beneficiaries, then preferential rates to ACP least-developed economies, other preferential rates to non least-developed ACP countries and other preferential rates to non-ACP least-developed economies. Preferences vary according to the economic status of states. The range of preferences given is an indication of the different levels of development achieved by the various groups of developing countries. The issues raised by these differences fall outside the scope of this discussion. The discussion below of options available to the ACP-EU contingent provides an example, however, of the complexity of developing country issues and their interaction with their developed country counterparts, who are themselves not a homogenous unit.

99 Stevens and Kennan, op cit note 89 at 30.

as a result of general liberalisation.[100]

While it is obvious that the aggrieved states stand to benefit from the adopted policies, the question which has yet to be answered is how important the ACP states are to the EU and how far they would be prepared to go to ensure that ACP preferences are preserved. The above recommendations seek compromises by the EU alone, or in the case of improved product coverage, both the EU and (to a much lesser extent) ACP states and Latin American countries. What would have to be determined is how the improved product coverage would affect EU producers of like products and how much opposition there would be to such a proposal.

On the same subject, Stevens and Kennan consider how the aggrieved parties could be placated. Like McQueen, they suggest that GSP preferences could be bound, with developing countries graduating out of preferences into full GATT/WTO tariff disciplines. They further suggest that the acceptability of a waiver would be increased by an agreement of open regionalism, so that the existing limited arrangements in Cotonou in favour of non-ACP developing countries which belong to a coherent geographical entity[101] could be enlarged to allow developing countries with a similar economic structure to the ACP, automatic membership of the trade cooperation provisions of a new agreement on the same terms as the ACP and least-developed countries. This would not only reduce the degree of discrimination of a new agreement and increase its acceptability in the WTO, but would also be of particular value to those Caribbean ACP countries which wish to deepen their economic links with some of the Latin American countries.

McQueen also suggests that a better option would be to place a new agreement in a stronger legal framework. This will in any case be necessary to cover special preferences for the least-developed countries and to cover GSP special preferences for Andean and Central American countries and for developing countries meeting labour and environmental standards. This could be done by extending either the Enabling Clause or Part IV of the GATT to include, under carefully specified conditions, discriminatory preferences for developing countries on the grounds that such preferences for least-

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100 Stevens and Kennan, op cit note 89 at 34.

101 An example being on cumulation of origin under Lomè Protocol 1, Article 6.5.

developed or economically-vulnerable economies would facilitate the diversification of the structure of their economies. The extension would enable them to obtain increased access in the largest possible measure to markets under favourable conditions for processed and manufactured products currently or potentially of particular interest to less-developed contracting parties.[102]

Stevens and Kennan have also raised the issue of special and differential treatment as a means of strengthening the legal foundation of the Cotonou Agreement. The Enabling Clause (1979)[103] paragraph 1, provides that developed states may discriminate against other developed countries in their trade policy provided that such discrimination benefits developing countries. The biggest problem which the EU would have in attempting to justify any of its preferential accords in this way, other than the standard GSP, is that the preferences do not cover all developing countries. It would be nearly impossible to overcome this limitation, unless the liberality of the Cotonou preferences was extended to all developing countries or reduced to the level currently available under the GSP, or something in between. Given the WTO goal of greater liberalisation, the EU would have to integrate the standard GSP countries into a broader framework that, over time, improves the access of all states.[104]

The problem with the move towards greater access for all developing countries under the Enabling Clause or Part IV of the GATT 1947 is two-fold. The major problem is that such increased access would most probably be one-sided. Paragraph 8 of Article XXXVI,[105] Part IV of GATT 1947, states that the developed contracting parties must not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties. The aggrieved parties, being mainly middle-income developing countries are subject to such protection. The problem faced by the EU is that the products which these countries seek to obtain greater access for are mainly agricultural goods, which are considered sensitive to the

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102 McQueen, op cit note 76 at 433.

103 WTO (1995:1049).

104 Stevens and Kennan, op cit note 89 at 13.

105 WTO, op cit note 4 at 533.

EU market and are therefore subject to much higher protection. Given that developing countries have adopted much higher tariff protection for their manufacturing industries, there is room for negotiation with both parties obtaining greater access to previously protected markets. Once again the question of how important these markets are to the EU remains. The other problem with this approach is that countries eligible for only standard GSP provisions tend to be more economically developed than other developing countries and therefore much more competitive. Increasing or deepening the preferences obtained by these developing countries would disadvantage other less-developed developing countries, nullifying or reducing any competitive advantage which the latter have obtained through more preferential access. A deepening of preferences obtained by standard GSP recipient countries could also provide a problem for the EU with respect to how to graduate these countries to the MFN rate.

The EU has, in its Green Paper, provided for the ACP countries to enter into free trade agreements with it upon the dissolution of the Cotonou Agreement. The "free trade agreement" option would be of greatest benefit for the EU because it does not have to negotiate with non-ACP states and consequently compromise itself. This is also the option which would seem to be the easiest to realise and obtain approval for. Theory and reality do not, unfortunately, allow for the same outcome. Two provisions of Article XXIV stand out and would be very difficult to realise given the make-up of the ACP states. Article XXIV (8)(b) requires that tariffs and other restrictive trade regulations be eliminated on substantially all the trade between the relevant states.[106] Article XXIV(5)(c) states that any interim agreement for the formation of a free-trade area must be completed within a reasonable length of time.[107] The Understanding on the Interpretation of Article XXIV of the GATT 1994 states that a reasonable length of time should exceed 10 years only in exceptional circumstances.[108]

The question of what constitutes "substantially all trade" remains. Does the "substantially all trade" provision relate to goods actually traded between the two partners or to all possible traded goods? The EU, in its negotiations with South Africa on the establishment of the SA-EU free trade area,

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106 WTO, op cit note 4 at 524.

107 WTO, op cit note 4 at 523.

108 WTO, op cit note 4 at 32.

interpreted this phrase to mean an average of 90 percent of the items currently traded between the two partners. South Africa accepted this definition. The difference in interpretation is important as a liberal interpretation could allow countries to continue protecting their economies. If trade between trading partners on particular goods constitutes only a small proportion of trade between these states, or is non-existent, a calculation based upon current flows will show the excluded items to be a very small proportion of the total. The more polarised a country's trading regime is between insensitive goods and very sensitive goods, the easier it will be to meet the 90 percent target as sensitive products can easily be excluded without upsetting the equation.

Another question of grave importance to the ACP countries is that of reciprocity. Most of the ACP states are either least-developed or lower to middle-income countries. As such, they have been protected by the non-reciprocity provision of Article XXXVI(8)[109] of GATT 1947 which states that developed contracting parties must not expect reciprocity for commitments made by them in trade negotiations with less-developed contracting parties. The lower or middle-income developing countries have been able to maintain highly protective barriers to trade in their domestic markets. This has been one of the benefits for the ACP countries under Lomé. Should these countries enter into free trade area negotiations with the EU either singly or regionally,[110] they will have to liberalise "substantially all trade" with the EU within a reasonable period of time for the proposed free trade areas to be acceptable under Article XXIV.[111]

The EU, in its negotiations with South Africa, has committed itself to an asymmetrical agreement under which the requirements on South Africa are less onerous than those on the EU. The parties have agreed that a larger proportion of EU imports must be made duty free. As a result 96 percent of the goods imported into the EU will be covered by the free trade area while only 86 percent of those imported into South Africa will be covered. With respect to the time period for liberalisation, the parties have agreed that the EU will liberalise over ten years, with South Africa being allowed

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109 WTO, op cit note 4 at 534.

110 As the ACP countries want.

111 Stevens and Kennan, op cit note 89 at 12.

an additional two.[112] While it would be futile to speculate as to the nature of any ACP-EU free trade areas, it seems likely that any free trade areas negotiated between the ACP states and the EU would be in the same vein as the EU-SA format.

While free trade areas between the EU and the ACP will continue to provide the ACP states with preferential access to the EU market and the ability to maintain their competitive advantage over rival developing and developed countries, there is a very real possibility of these states becoming captive markets for European goods, with no real provisions being made for development and growth within the ACP states. The outcome of such negotiations for the developing countries rests upon the strength of their negotiating parties and position. The ACP states have indicated a preference for joint negotiations on a regional basis as this will provide them with a stronger negotiating position. While there may indeed be strength in numbers, there is a very real danger of the needs of the poorer, less-powerful, least-developed economies being lost or overlooked as the more powerful nations within these regions push their own agendas forward. The complexity of the needs and trading positions of the ACP states could further complicate such negotiations. Trade between the EU and ACP countries has in the past been dominated by specific products from a select group of active ACP states. Most of these countries have very little to offer in terms of secondary or processed goods for export. Given the EU interpretation of "substantially all trade" there may be difficulty finding a proper balance between EU exports to ACP states and exports from the ACP to the EU. While the conclusion of free trade agreements between the ACP and EU which are satisfactory to both sides will give the ACP states the stability which they do not have under the Cotonou Agreement, the price which the ACP states may have to pay in terms of reciprocity and the ability to liberalise at their own pace may be very high. There also remains the question of whether such trading areas will be acceptable under Article XXIV, given the concessions which the EU may have to make to the ACP countries if such trading arrangements are to contribute to growth and development within these states.

No matter which option the ACP states and the EU agreed to, there would have to be sacrifice by both parties. As to which would have been the best option remains a question best answered by the affected parties. What remains a given is that with the expiry of the Cotonou Agreement the ACP

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112 Loc cit.

states would have lost their preferential access to the EU market. It is unlikely that the EU would have agreed to open its markets to all developing countries by deepening its GSP scheme as this would have expose it to greater competition from more aggressively competitive developing countries in South America and Asia. While obtaining a second waiver it may maintain the *status quo* at the cost of greater competition from other developing countries for access into EU markets, it will be a safer, less costly option for the ACP than the negotiation of free trade areas. Liberalisation of their markets, albeit over an extended period, could, however, be just the stimulus needed by these states to adopt more effective trade and economic domestic policies and move towards more stable political processes and policies. Whatever the outcome, it is clear that change is necessary for growth and development to occur within the fledgling ACP economies.

Regardless of the outcome, the way in which the ACP-EU trade relationship develops is important to all developing countries. While the Lomé Agreements did not fulfill all their aims, the focus on financial aid, preferential access to EU markets, relief from safeguard measures and other benefits derived from Cotonou which contribute towards economic growth and development, are more in keeping with the aims of positive discrimination and redress. Even with the limitation of the EU-ACP relationship and waiver to former colonies, the relationship is still of importance as it provides the world's poorest countries with a trading advantage which they would not have obtained elsewhere. The Cotonou Agreement also highlights some of the problems facing the WTO Member states. Even where the developed countries seek to accept the responsibility which comes with positive discrimination, one country cannot accept the responsibility for all developing states. It stands to reason that all the developed economies would have to do their bit, with the responsibilities being undertaken corresponding to the level of development of the developing economies which that country undertakes to mentor. The GATT has made provision for regional trade arrangements on the premise that smaller regional blocks adopting free trade principles are the fore-runners of true global free trade. This premise can be extended to regional undertakings because, while developed economies may in the short-term be required to make most trading concessions, in the longer-term they will be rewarded with greater access to much wealthier and promising developing economies.

In terms of increasing global economic welfare, long-term global welfare is dependent upon expanding developing country markets. Similarly, equal treatment of Member states requires that all

Member states have an equal chance of achieving growth and development through global trade. Previous analysis of global trading figures shows that the developing economies are at a gross disadvantage. Without deepening trade or arrangements such as the Cotonou Agreement, within a context of safeguard provisions which protect the developing economies from manipulation and entrench positive discrimination principles, the developing economies will continue to fare badly within the global arena.

A question which can be raised within the context of Cotonou is whether the preferential treatment given to the ACP states does not amount to unfair discrimination against other developing economies. As stated earlier, the Cotonou Agreement performs a function of redress, with former colonial powers extending preferences above and beyond those given to non-ACP developing states, aid packages *etc* as a means of facilitating the economic growth and development prospects of their former colonies. This is a legitimate EU goal, with there being a rational connection between the differentiation and the EU goal. As to whether there is proportionality between the means employed and the ends sought to be employed, it is necessary to look at the impact which the differentiation has on other developing economies. Although the EU provides ACP states with the most preferential treatment, it has not closed its markets to other developing markets but merely placed the needs of the ACP states, who consist mainly of the world's poorest states, before the needs of other developing states. Greater market access has given ACP states an added advantage over other developing economies. While the non-ACP states do not have equal access to EU markets, differences in preferences are in some cases, as small as 0.1 percent.[113]

Differences come with the access of sensitive goods into the EU markets, when other developing economies are limited by the common agricultural policy. It cannot be disputed that non-ACP countries do experience negative trade effects, as they are always competing with ACP states. The question is whether the preferential treatment is unfair. While normal preferential treatment is limited to preferential tariffs, the EU has gone beyond normal GSP treatment of ACP states and taken these countries under their proverbial wing. The treatment of ACP states by the EU, while it has not had

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113 This is the difference between least-developed ACP states and other LDC preferences on all goods, where tariff rates are 0.8 percent and 0.9 percent respectively.

the requisite effects, is more akin to redress than normal differentiation. As the former colonial states have taken it upon themselves to assist their former colonies, their treatment cannot be deemed unfair, especially as redress is seen as a means of dealing with inequalities between states and providing disadvantaged states with fair equality of opportunity. By placing the market access needs of ACP states before the needs of other states, developed or developing, the EU has provided the ACP states with a fair opportunity of success. The redress, itself, is in keeping with fair treatment of developing states.

Is the EU obliged to treat all developing economies equally? To answer this question one must look at the impact of such redress attempts on the EU. At present the EU is responsible for the needs of about 80 developing states, which is a massive responsibility for any state to adopt, especially if it intends to implement efficient and effective redress policies. While other developing economies do not have the same market access opportunities as the ACP states, they do obtain preferential treatment from other developed economies which can be equated to the EU-ACP trading arrangement. An example is the link between the Latin American countries and the USA or the ASEAN countries and Japan, the USA, Australia and New Zealand. For redress to be efficient, it must be implemented responsibly. The EU cannot be expected to deal with the needs of all developing economies but it can do its share. This is what the EU has been attempting to do, through Cotonou. While Cotonou may place the needs of the ACP states above other developing economies, the negative impact experienced by these states cannot be deemed greater than the benefits derived from Cotonou by the ACP states. Cotonou is therefore not unfair.

3.5 Conclusion

Decreasing MFN rates have resulted in a ever-decreasing margin between preferential GSP rates and MFN rates. The impact of these decreases is not as important as may first seem, however, as sensitive goods and tariffs peak products remain as protected as before. The GSP rates on these products are still valid. What is of more relevance to developing markets, however, is the high protection of labour-intensive primary and secondary products in developed markets, which effectively reduces the competitiveness of these goods on developed markets and undermines the goal sought to be

achieved by the GSP. Such protection of non-competitive domestic goods permits developed economies to discriminate unfairly against developing country goods. The GSP, as it is currently administered, permits developed economies to discriminate unfairly against developing economies. The Cotonou Agreement, with its focus on aid and increased preferences on all goods, permits the EU to address developing country concerns in a manner which goes beyond a superficial response to developing country needs. Whatever the fate of the Cotonou states, the extent of commitment shown by states to the process of liberalisation provides a good example of what form the GSP can take, if it is to really focus on addressing the needs of developing countries.

Chapter 4

Trade and labour

4.1 Introduction

Greater trade liberalisation through the General Agreement on Tariffs and Trade (GATT) has facilitated entry of developed country exports into the usually highly protected developing country markets.[1] While developed economies are exporters of technologically advanced goods, most goods imported from developing countries have been highly labour-intensive, for example, textiles, toys, rugs *etc.* Because of the extreme poverty and high levels of unemployment in developing countries, industries have benefited from the extremely low cost of unskilled labour. Together with the abundance of raw materials, this has given many developing countries a comparative advantage over developed economies in labour-intensive products. The increased demand for low-skilled workers in the developing countries has coincided with a fall in demand for less-skilled workers in advanced countries.[2] While low labour costs are what contribute towards the comparative advantage of developing economies, the developed economies view these low labour costs with some concern.

Low labour costs have been linked to inadequate concern for labour rights and increased pressure is being placed on all Member states to accept labour rights as part of the WTO agenda. The focus of this chapter is on how developing economies will be affected by an aggressive labour rights package within the GATT. More specifically, given the level of development achieved by many developing countries, are such provisions feasible or are they merely protectionist measures adopted by the developed economies to reduce the comparative advantage enjoyed by developing economies? In

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1 For more on protectionism, see Bhagwati (1988:1-130) and Ball (1987:1-21). While North-North protectionism was prevalent, North-South protectionism was further influenced by the disparity between bargaining power of developed and developing countries, and the fact that many developing countries were not bound by the GATT provisions owing to non-membership and were therefore not bound by the most-favoured nation principle.

2 Hoekman and Kostecki (2001:448-453).

order to answer this question, it is necessary to look first at the issues and the economic effects of a social clause. The role which the International Labour Organisation (ILO) plays will then be discussed, together with the question of whether the GATT/WTO is actually an appropriate forum for discussing labour issues.

4.2 The issues

As the falling demand for less-skilled workers in advanced countries has coincided with increased imports of manufactured goods from developing countries, economists, labour lawyers and politicians have begun to question the economic consequences of trade between developed and developing economies.[3] The advanced countries are worried about the possible adverse economic effects of trade. The primary question raised by economists and politicians alike is whether wages and employment of low-skill workers in advanced industrial countries are and will be determined by the global supply of less-skilled labour rather than by conditions in domestic labour markets.[4] The increased imports of manufactured goods from low-wage countries, mostly developing economies, have been blamed for the increasing job losses among less-skilled workers and social dislocation in developed countries. The relocation of some multinational companies to low-wage developing countries has been an added source of anxiety.[5] The loss of jobs by less-skilled developed country workers has coincided with increased public awareness of the exploitative labour practices of some developing country governments. Of primary concern has been the misuse of child, forced and prison labour. Increased public awareness of labour issues has led to the "voluntary" adoption of codes of conduct by multinational companies[6] as a means of demonstrating their commitment to ethical standards and maintaining market share. Issues commonly covered by codes of conduct are employment conditions, commitment to equal opportunities, forced labour and child labour as well

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3 Lee (1997:173-176) and Freeman (1995:16).

4 Freeman, op cit note 3 at 16.

5 Lee, op cit note 3 at 176.

6 Levi Strauss, the first company to adopt such a code in 1992, has been joined by Liz Claiborne, Reebok, Nike, The Gap and Starbucks, amongst others.

as environmental protection.[7] Increased public awareness of the exploitative labour practices allowed by some developing-country governments[8] together with the political reactions of developed-country governments to increasing job losses in industrialised countries most probably contributed to the call for a social clause to be included in the GATT 1994.[9]

The social clause envisaged by developed economies is one whereby a social dimension is brought to the trade (GATT) rules, with labour standards being made a condition for access to foreign sales.[10] Those in favour of the social clause have based their argument on the issue of fair trade. Central to this argument is the belief that competitive advantage can sometimes be morally illegitimate. It is argued that if labour standards elsewhere are different and unacceptable morally, then the resulting competition is morally illegitimate and unfair. A social clause is therefore needed to eliminate unfair trade competition derived from labour exploitation. Trade sanctions are seen as the most effective means of achieving this.[11]

The position of the developing economies on the issue of a social clause and thus the adoption of minimum international labour standards[12] by WTO Member states is different. Governments in developing countries feel that the call for a social clause is prompted by developed countries' concern about the export success of the developing economies. The social clause is therefore considered to be disguised protectionism which could obstruct their industrial development and deprive them of the comparative advantage supplied by low-cost labour productivity. The imposition of a social clause is considered to be unwarranted interference in their domestic affairs. Developing countries also resent the fact that the developed economies may be asking for reciprocity of social obligations

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7 Tan and Reeves (1996:176).

8 Bollé (1998:391-413).

9 Lee, op cit note 3 at 176.

10 Tan and Reeves, op cit note 7 at 15..

11 Van Dijck and Faber (1996:38-40).

12 Much confusion as to the meaning of a social clause exists. Despite the various arguments, a social clause is understood to be a set of minimum international labour standards to be adopted by all WTO Members and enforced through trade sanctions (Bhagwati and Hudec, 1996:177-180).

4.3 Economic issues

Arguments for or against labour rights can be divided into eight groups, of human rights and efficiency arguments, the collective action problem, sovereignty and pragmatic arguments, and policy consistency, institutional and rock bottom arguments.[17] Of these arguments, only the efficiency and sovereignty arguments are really based upon economic theory. These theories will therefore be considered below. In addition to general arguments about labour rights, the ILO has made a distinction between labour market standards that are focused on outcomes and those which focus on processes. The 1998 ILO Declaration on Fundamental Principles at Work binds all 175 Member states to four core labour standards.[18] The core labour standards are largely process-related; that is, they concern the organisation of the labour market without specifying any particular market outcome, unlike outcome-related standards which are always dependent on levels of productivity and economic development.[19] Core labour standards will be discussed together with the arguments which have been attached to these standards in order to determine the effect of the adoption of international labour standards on developing economies.

4.3.1 Economic Arguments

4.3.1.1 Efficiency Argument

The first efficiency argument refers to the "race to the bottom" or level playing field debate. The race to the bottom argument states that countries and firms, in a bid to remain competitive, will lower their wages or labour standards until they reach or are lower than wages in developing countries. The immobility of labour relative to capital is used to support this argument, as domestic firms will relocate to other locations in pursuit of cheaper labour.[20] The threat of relocation could also be used

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17 Langille (1997:17).

18 Brown (2001:93).

19 Brown, op cit note 18 at 95.

20 Bhagwati and Hudec, op cit note 12 at 237.

in the political process, resulting in the alteration of regulatory standards or resistance to higher standards. The exit option of capital has also been used to support the race to the bottom argument.[21] The exit option refers to the inequality of bargaining power as the ability of capital to move elsewhere has resulted in an imbalance in bargaining power between parties. This claim assumes that governments will respond to lower foreign labour costs by lowering domestic standards below an optimal level.[22] Governments do not generally respond in this way, as a wide range of alternatives are available, for example, better regulation which reduces compliance costs without lowering standards, or investment in training, or technology to increase labour productivity. Where governments respond by lowering standards, rather than choosing better policy alternatives, this response may be indicative of political and social problems within these countries.[23]

Linked to the race to the bottom argument are allegations of social dumping. Social dumping is based on the idea that different labour standards elsewhere will give foreign producers an unfair competitive advantage, leading to loss of employment and market share for developed country producers.[24] According to Langille[25] the social dumping argument is economically incoherent since trade economists insist that trade depends on differences such as varying levels of economic development, factor endowments or policy choices. The level playing field argument has been similarly dispelled. Trebilcock and Howse[26] state that assuming there is nothing wrongful about a country's labour policies, there is no reason why a cost advantage attributable to these divergent policies should not be treated like any other cost advantage, *ie* as part and parcel of comparative advantage. Langille agrees with this view, stating that differences alone cannot matter. If another country's labour policies

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21 Bhagwati and Hudec, op cit note 12 at 235-247.

22 Trebilcock and Howse (1999:455).

23 Loc cit.

24 Langille, op cit note 17 at 24.

25 Loc cit.

26 Trebilcock and Howse (1996:74).

are better, supporting a better trained, more participatory and more productive workforce which creates a national advantage, other countries have no cause to complain.[27]

The level playing field or race to the bottom argument has another non-trade element, however. This is the element which links labour standards to foreign direct investment and mobile capital.[28] This link has an offensive and a defensive element. The defensive element is discussed below. Langille states that the race to the bottom argument, properly understood, refers to the fact that in a world of imperfect employment markets, there are incentives to attract investment with countries reducing their labour standards in order to do so. It is not a blanket assertion for the need to lower the playing field. While there is nothing wrong with attracting investment, there is something problematic with the situation in which every jurisdiction reduces what it acknowledges to be optimal labour standards. This will result in a world in which no gains are secured, because no jurisdiction will secure additional investment if all countries make the same move.

A controversial question raised is whether individual nations do, in fact, attract foreign direct investment through changes in their labour or other social policy. The World Employment Report[29] concludes that empirical evidence on the direct relationship between foreign direct investment (FDI) and core labour standards is scarce and remains open to different interpretations. Although core labour standards may not be systematically absent from investment decisions of OECD investors in favour of non-OECD destinations, aggregate FDI data suggests that core labour standards are not a primary factor in the majority of investment by OECD companies. Some governments in non-OECD countries have, however, restricted labour rights especially in export processing zones, in the belief that doing so will help attract inward FDI from both OECD and non-OECD investors. Langille adds that while empirical evidence remains scarce, this idea has become commonplace in political debates. In labour relations matters, whether collective bargaining within firms or in political lobbying of

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27 Langille, op cit note 17 at 25.

28 Langille, op cit note 17 at 30.

29 ILO (1994:9).

governments, it is not actual divestment or investment which is the real key but rather the threat of such actions. Actual investment/or divestment data may represent just the tip of the iceberg.[30]

The second efficiency argument is based on what the data shows and seeks to determine the welfare effects of any effort to pursue the international human rights agenda. The crucial question here is whether there is a trade-off between the goal of economic efficiency and respecting labour rights.[31] The European Commission Non-Paper on Reciprocal Accusations of Social Dumping and Hidden Protectionism[32] deals with this issue. In this paper the OECD found that core labour standards concentrating on freedom of association, non-discrimination, child labour and forced labour do not play a significant role in shaping trade performance. According to the report, the view that low-standards countries will enjoy gains in export markets to the detriment of high-standards countries appears to lack solid empirical support. Any fear on the part of developing countries that better core standards will negatively affect either their economic performance or their competitive position in world markets has no economic rationale. It is, however, conceivable that the observance of core standards will strengthen the long-term economic performance of all countries.[33]

With reference to freedom of association and its relationship to trade liberalisation, the report states that the more successful the trade reform in terms of the degree of trade liberalisation achieved, the greater is the respect for association rights in the country. The clearest and most reliable finding favours a mutually supportive relationship between successfully sustained trade reforms and improvements in association and bargaining rights. There is similarly no case where promoting freedom of association and bargaining rights impede trade. For these economies, fears that freer trade could lead to an erosion of labour standards or that improved compliance with them could jeopardise trade reforms are unfounded.[34] The importance of this conclusion is that it removes any grounds

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30 Langille, op cit note 17 at 32.

31 Langille, op cit note 17 at 26.

32 OECD (1996: 105).

33 Loc cit.

34 OECD, op cit note 32 at 111-112.

which developed countries have had in pursuing this argument for protectionist purposes. It also prevents the developing economies from utilising this argument to avoid adopting their core labour rights.

The third efficiency argument is based upon the idea that there are already in place within the central mechanisms and fundamental theory of the world liberal trading order the seeds of the international labour standards idea. As a result, free traders are already committed to fair trade. The issue, however, is the political definition of fairness.[35] Langille has simplified the argument as follows. Free trade arrangements have, to a large extent, achieved the goal of reducing domestic tariffs on foreign goods. The attention of international free trade regimes is now turning away from border controls to non-border controls, including subsidies. There is no difference from the point of view of a foreign producer whether a nation establishes tariff barriers to the import of their goods, or directly subsidises domestic competing producers. If this point is accepted, there is therefore no difference between what may be labelled positive or negative subsidies. For example, there is no difference between providing financial subsidies to equip domestic producers to meet pollution control or labour requirements or not imposing these requirements in the first place.[36]

Non-regulation can also be seen as a subsidy. Another way of stating this point is saying that current trade theory depends upon some preconceived, often unarticulated assumption about the natural baseline of economic ordering. The unarticulated, undefined and natural baseline is the unregulated market. This is simply to declare a political preference for one mode of governance over another. Langille states that this is a problem already existing within trade theory. It is meant to challenge those who argue against the idea of defining international labour standards, yet who defend the existing world trade regime. Where theorists hold this position, they are committed to defending some baseline of normal regulation. This, however, is just what the international labour debate is about. It is an argument that the old and the new are mutually reinforcing and that the old requires

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35 Langille, op cit note 17 at 29.

36 Loc cit.

the new.[37]

The argument on national sovereignty is linked to the labour standards debate. This argument states that the pursuit of international labour standards will jeopardise national sovereignty. There are two aspects to this argument. The first is that it is commonplace to note the diminished sovereignty of individual nation states.[38] Lawrence, Bressand and Ito[39] state that as factors of production become mobile, regulations and taxes that raise local production costs become increasingly extensive. In a closed domestic market, producers can either reduce production or bear the cost of the regulation or tax. In an open economy, production can be shifted abroad. As foreign locations become closer substitutes, the ease of relocation ceases, with governments being increasingly forced to take account of other countries' regulations in making their own choices. Countries seeking to attract and keep multinational companies are under increasing pressure to adopt internationally compatible operating rules, intellectual property rights and technical standards and regulations. The resulting pressures on national policy are very important because of the increased responsibility which national governments have assumed for the living standards and the quality of life of their citizens. The mismatch between government obligations and their ability to deliver while acting autonomously is growing.[40] As a result of the collective action problems present, it is no longer plausible to argue that nations should not cede their sovereignty to international bodies. Within the new global era, opportunities for agreement may, to the contrary, represent ways and means of reclaiming some element of sovereignty over issues such as labour policy.[41]

The other aspect of the sovereignty argument is that sovereignty elsewhere must always be respected. This has become an increasingly problematic argument from a human rights perspective as the human rights view does not take into account efficiency aspects, concentrating on the right rather than the

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37 Langille, op cit note 17 at 29-30.

38 Langille, op cit note 17 at 33.

39 Lawrence, Bressand and Ito (1996:19).

40 Loc cit.

41 Langille, op cit note 17 at 34.

economic effect of the enforcement of rights.[42] Arguments on the advantages of free trade are based upon the legitimate recognition of policy choices made elsewhere. Within economic arguments, however, respect for choices elsewhere and the legitimacy of those choices affecting our choices, are always conditional upon choices elsewhere being free and fully informed. Political or policy choices made elsewhere must therefore be a result of legitimate political processes.[43] While the way that states treat their subjects has generally been seen as a purely domestic matter, the conditions that have created pressures for deeper economic integration, and integration itself, have severely tested this principle. Increasing economic openness exposes domestic policies to foreign scrutiny because these policies affect foreigners and because open communication makes government wrongs against their own citizens visible throughout the world. Treaty obligations and foreign pressures can support constitutional provisions designed to ensure that government policies reflect enduring convictions. Just as markets fail when they do not accurately represent consumer preferences, political systems fail in that they grossly misrepresent the views or violate the interests of their citizens.[44] The sovereignty argument encompasses both human rights concerns and economic theory. According to Langille,[45] the fundamental point is that there is no argument for sovereignty to which either trade theory or international human rights theory is responsive.

The economic arguments put forward are based upon the premise of the adoption of only core labour standards as international labour standards. With these standards being process and not outcome-related, the economic argument was based more on the virtues of international labour standards as opposed to the impact of labour standards upon the economies of developing economies. Langille, in his discussion of the various arguments put forward in favour of or against international labour standards, has come out in favour of the adoption of international labour standards while effectively dismissing protectionist claims about lower labour standards. The basis for this argument will only be understood by explaining core labour standards and the rationale behind them.

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42 Langille, op cit note 17 at 19-21.

43 Langille, op cit note 17 at 34.

44 Lawrence, Bressand and Ito, op cit note 39 at 52-54.

45 Langille, op cit note 17 at 35.

4.3.2 Core Labour Standards

All members and states belonging to the International Labour Organisation have accepted the following four labour provisions as core labour standards:[46]

i) freedom of association and the effective recognition of the right to collective bargaining;
ii) the elimination of all forms of forced, or compulsory labour;
iii) the effective abolition of child labour;
iv) the elimination of discrimination in respect of employment and occupation.

Even with the adoption of these standards as fundamental rights, there is no consensus amongst states as to what the appropriate labour standards should be.[47] The 1996 OECD report[48] has isolated labour standards that either reflect near universally-held values and/or play a role in the efficient function of labour markets. The report provides that standards such as freedom of association, the right to collective bargaining, prohibition of child labour and the principle of non-discrimination can be imposed within LDCs who have achieved only minimal development and can actually promote economic growth. The biggest problem faced in the adoption of these standards is that the efficiency-enhancing labour standards cannot be neatly linked to humanitarian values, as these connections are often controversial and ambiguous. Brown refers to the area of bonded labour contracts to emphasise this point.[49]

While the act of choosing to be bonded is voluntary, once bonded, workers are no longer free. Extremely poor workers frequently have no access to formal capital markets and are therefore forced to offer their own labour as collateral to obtain a loan. While such arrangements may be mutually

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46 Loc cit.

47 Brown, op cit note 18 at 94.

48 Loc cit.

49 Brown, op cit note 15 at 95.

agreed upon by the worker and the employer prior to the bonding contract being signed, banning such contracts may be justified if they result from limited information or rationality on the part of the worker. The legality of bonded labour contracts may actually inhibit the development of formal capital markets[50] as banks may be unwilling to extend loans to workers who have the option of obtaining a second loan by bonding their labour. This occurs because the bondholder presumably has greater power to enforce the loan agreement than the bank, thereby raising the default risk for the bank. In such cases, outlawing bonded labour contracts can actually improve the options for the worker by lowering the default risk for formal credit institutions.[51]

Standard efficiency arguments are also weakened by political feasibility. An example given by Brown is that of employment. Discrimination prevents workers from obtaining the jobs to which they are best-suited, thereby lowering the value of output. There do, however, exist situations where discrimination has proved Pareto-improving for political economy reasons. An example is Mauritius which set out a development strategy that depended on operating an export-processing zone. To obtain support for the export-processing zones, the government employed females.[52] The segmentation of the labour force was critical to the policy's success as it enabled male workers and import-competing producers to continue production under the same conditions as before the introduction of the export-oriented development strategy. The interests of those benefiting from long-standing protection were preserved by continuing protection of existing industries that hired males while export-processing zones had new opportunities opened to them. The Pareto-improving step was made feasible by segmenting the labour market along gender lines. Policies such as those which address entrenched cultural patterns would not pass a strict non-discrimination test.[53]

The expected outcome of collective bargaining is similarly uncertain because of the two faces of unionism. In many cases, a union can improve dispute resolution, provide a channel of information

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50 Loc cit.

51 Loc cit.

52 Brown, op cit note 18 at 96.

53 Loc cit.

from worker to employer and coordinate the differing views among workers relating to the trade-off between working conditions and wages. Where the union behaves like a monopoly in an otherwise competitive market, and favours the interests of a small elite at the expense of a large group of excluded workers, then the efficiency effects are negative.[54] The banning of child labour also comes with its own questions. An example is given of the situation of families who put their children to work only when the adult wage is below some critical level at which the family's survival is threatened. When child labour decisions are dependent on the adult wage in this manner, two labour market equilibria may emerge.[55] In the low wage child-labour equilibrium, children and their parents work because the adult wage is below the critical level at which children are withdrawn from the labour market. A ban on child labour which requires parents to withdraw their children from the labour force contracts the supply of labour and may give rise to a second equilibrium with an adult wage above the critical level at which children no longer work. A ban on child labour is effective only if it redistributes income from capital to labour in such a way as to change a family's child-labour decisions.[56]

While attention is usually focused on poverty as a root cause of child labour, Baland and Robinson[57] focus on the role of capital market failure. Poor families, presumably, analyse the trade-off between work and schooling in part by comparing the present discounted value of an education relative to present income. They argue that the relative return to education is as high or higher for a poor child than for children generally. Poor parents may, however, still choose to put their children to work if they cannot borrow against their educated child's future income. In such a situation, a ban on child labour may be part of a strategy for improving the efficiency of the labour market when combined with a programme which gives poor families access to capital markets or otherwise repairs the capital market failure.[58]

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54 Loc cit.

55 Loc cit.

56 Loc cit.

57 Baland and Robinson (2000:663-79).

58 Loc cit.

Steps taken to reduce forced labour, child labour and discriminatory behaviour or to support free association and collective bargaining will frequently have varied results. Realising the potential efficiency, equity and humanitarian benefits of core standards may depend on first correcting ancillary market or political failures. Brown states that we cannot make a general statement that universal labour standards derived from commonly-held moral values will always produce positive economic outcomes. The effect of labour standards on economic performance and the lives of labourers cannot be presumed to be positive, but must instead be empirically investigated on a country-by-country basis.[59]

Economic analysis of the arguments given in support of labour standards expose many of these arguments as protectionist and morally rather than economically based. Analysis does show, however, that adoption of core labour standards may actually be economically efficient and benefit developing economies. Brown's analysis of core labour standards shows, however, that there are no easy answers or solutions. Application of core labour standards determines whether they increase or decrease labour market and, consequently, domestic market efficiency. From an economic perspective, adoption of core labour standards by developing economies may actually increase market efficiency within these economies. Results will depend upon the attitude adopted by these countries towards the application of these standards. Brown's analysis has raised another element: evidence that in isolated cases the very behaviour which core standards seek to eliminate may actually contribute towards Pareto-efficiency. Strict application of the non-discrimination provision in this instance may actually deprive labourers of the gains made under discrimination. The ILO, in targeting only the four core labour standards, has identified those labour provisions which are problematic to both developed and developing countries alike. Brown refers to the problems which the United States has with ratification of the standards pertaining to non-discrimination, forced labour or the right to free association and collective bargaining.[60]

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59 Brown, op cit note 18 at 97.

60 Brown, op cit note 18 at 94.

4.4 Labour Standards, the International Labour Organisation (ILO) and the General Agreement on Tariffs and Trade (GATT) 1994

4.4.1 The International Labour Organisation (ILO)

Having established that core labour standards are not, in themselves, protectionist and may actually enhance the growth prospects of developing economies, the next step is to determine the appropriate forum for the enforcement of labour standards. While the ILO is the official labour body, states have proclaimed it to be ineffective since it refuses to utilise trade sanctions as a means of ensuring compliance. The social clause, on the other hand, calls for both recognition of a core set of labour rights and the use of force, through sanctions, to ensure compliance. The GATT has been suggested as the proper forum because of its acceptance of trade sanctions to force compliance as well as the link between trade and labour. Both the ILO and the GATT will be considered, with the strengths and weaknesses of each being analysed in order to determine which has the greatest ability to provide an effective and fair outcome.

At the Ministerial Conference of 9-13 December 1996 held in Singapore,[61] Ministers of the WTO Member states made a commitment to observe internationally recognised core labour standards. The Ministers acknowledged that the ILO is a competent body to set and deal with labour standards and affirmed their support for the work of the ILO in promoting labour standards.[62] They agreed that economic growth and development fostered by increased trade and further trade liberalisation could contribute to the promotion of these standards. The use of labour standards for protectionist purposes was rejected, with the Ministers agreeing that the comparative advantage of countries, particularly low-wage developing countries, must in no way be questioned. In this regard, they noted that the WTO and ILO Secretariats would continue their existing collaboration.

Despite the support promised by the Ministers of GATT Member states to the ILO, and their

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61 Known as the Singapore Ministerial Declaration.

62 The Declaration on core labour standards can be found in Article 4, *Singapore Ministerial Declaration*, 13 December 1996.

commitment to the institution and its work, the issue of a social clause persists because the ILO refuses to commit itself to the path of force through trade sanctions. In order to ascertain whether trade sanctions are necessary within an ILO context, the fundamental principles of the ILO and the mechanisms for the enforcement of ILO principles need to be determined. The ILO Declaration on Fundamental Principles and Rights at Work[63] sets out the fundamental rights of the ILO. In accordance with ILO policy, all members, regardless of whether they have ratified the relevant ILO Conventions, have an obligation which arises from the very fact of membership of the ILO, to respect, promote and to realise, in good faith, the principles concerning the fundamental rights of the ILO.[64] These fundamental principles are the freedom of association and the effective recognition of the right to collective bargaining, the elimination of all forms of forced or compulsory labour, the effective abolition of child labour and the elimination of discrimination in respect of employment and occupation.[65]

This is the first time ILO member states have agreed upon a core set of fundamental labour rights. Members also recognised the obligation which the ILO has to assist those members not yet in a position to ratify some or all of the ILO Conventions in an effort to respect, promote and realise the principles concerning fundamental rights which are subject to these Conventions.[66] The ILO would help its members by making full use of its constitutional, operational and budgetary resources. These include the mobilisation of external resources and support as well as the encouragement of other international organisations with whom the ILO has established relations.[67] The Declaration[68] stresses that labour standards should not be used for protectionist trade purposes, and that nothing in the

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63 This Declaration was adopted by the International Labour Conference at its 86th Session, Geneva, 18 June 1998. It confirms the fundamental principles of labour rights and human rights set out in the ILO's constitution of 1919 and the Declaration of Philadelphia of 1944. For more on the background of the ILO see (1998:127-133) and Valticos (1998:135-145).

64 Article 2, ILO (1998:7).

65 Article 2(a-d), op cit note 64 at 7.

66 Article 3b, ILO, op cit note 64 at 7.

67 Article 3, ILO, op cit note 64 at 7.

68 Article 5, ILO, op cit note 64 at 8. Institutions with whom the ILO has links are the World Bank and the International Money Fund, amongst others. Bhagwati and Hudec, op cit note 12 at 188.

Declaration should be invoked or otherwise used for such purposes. The comparative advantage of any country is not to be questioned by the Declaration.

The Declaration on Fundamental Principles and Rights at Work contains all the provisions necessary for the protection of core labour rights. The dissatisfaction of the pro-labour protection lobby lies in the means of enforcement of these principles by the ILO. The ILO has 174 member states who are represented at all levels of the ILO by government, workers and employers delegates who work together on an equal basis. The International Labour Conference works out and adopts international standards in the form of Conventions and Recommendations.[69] The ILO Conventions are international treaties, binding on countries that ratify them. Countries bound by a Convention have to apply its terms and provisions. Recommendations do not require ratification as they are not international treaties; they merely amplify the Conventions or deal with questions which do not call for formal obligations. They serve as guidelines for national policy in given areas. When Conventions and Recommendations have been adopted by the International Labour Conference, member states must submit them to their parliaments or other legislative authorities who have 18 months to decide whether to accept them. Where a Convention is ratified, governments are expected to make annual reports to the ILO on its application. These reports are studied by a committee of independent experts and a tripartite committee of the Conference. From these reports, the ILO can determine what difficulties governments are having in putting the Conventions into effect and provide assistance.[70] Where governments have not ratified Conventions or adopted Recommendations, the ILO has the option of asking governments to present reports indicating how their legislation and national practice meet these standards. Where they do not, governments may have to present a report on the difficulties encountered in the application of the Conventions and Recommendations.[71]

Where employers and workers of a Member state are unhappy about the non-observance of ratified

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69 Tan and Reeves, op cit note 7 at 47.

70 Tan and Reeves, op cit note 7 at 49.

71 Tan and Reeves, op cit note 7 at 50.

Conventions, they may address their grievances to the International Labour Office.[72] The ILO Governing Body will then bring the complaint to the attention of the relevant government and invite the government to respond as it sees fit. Member states may also bring complaints against other Member states who have ratified the same Conventions, if they are dissatisfied with their observance of the Convention. The Governing Body will then refer the complaint to the relevant government, asking for a response, or refer the complaint to a Commission of Enquiry for consideration. Member states must place all information relevant to the complaint at the disposal of the Commission.

The Director-General of the ILO is informed of the findings and recommendations of the Commission. He will then inform the governments and the Governing Body of the findings of the Commission. The governments must inform the Director-General if they accept the Commission's Recommendations or if they intend to refer the complaint to the International Court of Justice. They have three months in which to do so. The International Court of Justice is the final court of complaint. Where a member fails to carry out the decisions of the Commission of Enquiry or the International Court of Justice, the Governing Body may recommend to the Conference actions which it deems wise and expedient to secure compliance.[73] The ILO may, in cases of extreme provocation, call for the suspension or expulsion of a Member state from its ranks. Implementation requires ratification by two-thirds of the ILO Member states. While the ILO is against the habit of resorting to power, these measures were adopted to demonstrate the ILO's distaste for apartheid legislation and resulted in South Africa announcing its withdrawal from the ILO on 11 March 1964.[74]

Rather than implementing trade sanctions, the ILO prefers to rely on various forms of persuasion and pressure. Emphasis is also placed on the importance of assistance to member states having difficulties in implementing ILO standards. The ILO has also given preference to conciliatory measures and adopted a pragmatic approach to upholding the organisations rules. A more likely reason for the ILO's pragmatic stance has been determined to be the inability of the ILO's tripartite constituencies

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72 Loc cit.

73 Tan and Reeves, op cit note 7 at 50. See also Bhagwati and Hudec, op cit note 12 at 185-90.

74 Imber (1989:52).

(representatives of workers, employers organisations and governments), to agree on a common approach.[75]

The issue of linking trade and workers rights has been discussed by the various Director-Generals of the ILO. The earliest such discussion occurred in 1973. No conclusion was reached. Extensive talks were again held in 1984. These discussions revealed a number of difficulties, both in principle and practice. The ILO perceived labour costs to be only one aspect of international competitiveness. The tripartite assembly was also convinced that the improvement of labour conditions is a complex issue, and one best resolved through multilateral negotiation between social partners and eventual agreement on common principles, rather than through sanctions.[76] Issues raised in the discussion of the social clause are, amongst others, the fact that while a successfully implemented social clause can be expected to exert a favourable influence on the formal export sector, it may widen the gap between those working in this sector and those within the informal sector, who tend to be poorer and in greater need of protection.[77] A question raised by the conference was whether a social clause would pre-empt protectionist pressures that could otherwise emerge or whether it would basically replace open protectionism with hidden protectionism. The answer depends on whether or not the standards included in a social clause would raise labour costs.

Edgren[78] discussed the extent to which adoption of fair labour standards would affect production costs and thus the international competitiveness of export producers in low-wage countries. According to Edgren, the right guaranteeing freedom of association and the right to negotiate collectively, would probably have their greatest cost effects outside manufacturing, particularly in services and agriculture. Rights relating to safety and health would only in exceptional circumstances have cost implications. He doubts that they would have a significant effect on average production

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75 Bhagwati and Hudec, op cit note 12 at 189.

76 Loc cit.

77 Van Liemt (1989:436). This article contains the issues dealt with by the ILO during their second conference on a social clause. See also Servais (1989:423-32).

78 Edgren (1979:529). The cost effects and their consequences for trade were not systematically analysed in the case of developing countries. Edgren admits that even the few studies that have been done in industrialised countries are far from conclusive.

costs in an industry, particularly where existing international differences in unit wage costs are taken into consideration. Taking into account the above analysis, the fair labour standard system would be more effective as an instrument for international solidarity between workers than as an instrument for protecting developed countries against trade competition from low-wage countries.[79] Where applied strictly and universally, a social clause could therefore be an effective instrument in bringing about a floor in working conditions everywhere. A loose and less than universal application, on the other hand, could pose an immediate threat to the economic and employment situation in developing countries as it will probably encourage protectionist pressures and behaviour. This is especially so where countries are operating in a highly competitive export environment dealing in labour-intensive products.[80]

Two issues which concerned the 1984 ILO Panel on a social clause were the issues of willingness of states to participate in a multilaterally operated social clause and the supervisory procedure to be applied. The ILO Panel felt that trade is a two-way relationship and not a privilege to be given to some and withheld from others. Trading parties develop trade relations because both expect to benefit from the relationship. Cutting trading ties, depending on the nature of the product exported, could therefore harm both importer and exporter. Secondary effects of trade sanctions should also be considered. Heavily indebted countries need to export manufactured goods at full capacity as they need large amounts of foreign exchange in order to decrease their foreign debt. Trade sanctions could force these countries to default on their debts, which would then have grave consequences for the mostly developed country creditors. The lodging of trade sanctions against a violating country is likely to be seen as an unfriendly act. Most small governments would therefore be reluctant to lodge complaints, especially against larger, more powerful trading partners, as they fear retaliation and cannot afford to lose trading volumes. This is especially so where these countries are experiencing balance-of-payments problems.[81]

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79 Loc cit.

80 Loc cit.

81 Van Liemt, op cit note 77 at 445. There exists an incorrect assumption that developing economies, alone, will be affected by enforced labour standards. While they are, generally, less labour friendly that the developed states, the developed states are also guilty of unfriendly labour practices, for example, sweat shops and lack of freedom of association within the USA. Even where these states

The supervisory procedure envisioned by the ILO would be based on periodic reporting, a complaints procedure, or a combination of the two. The complaints procedure could follow a broad approach or a narrow one. A broad approach would enable a large number of people and/or institutions to participate in the procedure. With a narrow approach the parties who could complain would be restricted to governments alone.[82] This approach has had limited success because parties fear that complaints would lead to reprisals in the form of counter-complaints. For a broad approach to work, however, a procedure would be needed for deciding on the merits of each case and the priority to be given to each complaint. This could require a decision to be taken on which specific standards would be considered more important and thus violations of which standards would be given priority.[83] With a narrow approach, small economies, in addition to feeling vulnerable to retaliation, would also have little chance of success against more powerful economies which have the funds to get the best legal advice and the resources to employ stalling techniques.[84]

The 1994 ILO discussion of a social clause was preceded by proposals by Michel Hansenne,[85] Director-General of the ILO. In his paper on a social clause Hansenne states that the ILO supports neither restrictions on trade nor compulsory equalisation of social costs as both are contrary to the premises on which the ILO is based. The ILO's role is not to put right distortions in international competition which arise from the different levels of social protection that countries offer their workers. This is the domain of the WTO. Liberalisation is only the ILO's concern where it affects both the ability and the will of states to pursue the social objectives embodied in the ILO constitution.

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may not be directly involved in labour unfriendly practices, Multinational companies from developed nations have been known to utilise child labour in developing countries or contribute directly to labour abuses within these states.

82 Loc cit.

83 This decision is critical as the ILO would have to ensure that the minimum standards adopted commanded sufficient support from all states who would not see the implementation of these rights as unjustifiable interference in their domestic affairs. Another problem was the criteria for choosing the rights to be included in a social clause. The Council used social, legal and economic criteria. For more on the problems encountered in the determination of minimum labour standards, see Van Liemt, op cit note 76 at 436-38. The GATT dispute settlement body could be utilised, given that states agree upon a common set of minimum labour standards.

84 Van Liemt, op cit note 76 at 445-46.

85 Hansenne (1996:230-38).

For the ILO the issue is how to find an effective means of ensuring that social progress goes hand in hand with the liberalisation of trade and the globalisation of the economy. The challenge to the ILO is how to ensure that all Members of the WTO who are also ILO members play the game of social progress fairly, despite the constraints and temptations of fierce competition. These challenges are:[86]

a) that free trade is accepted for its contribution to economic development, improvement of standards of work and life, and the creation of jobs; and
b) the ILO relies on cooperation, not coercion.

Hansenne expresses reservations concerning unilateral actions by individual states or groupings of states linking trade concessions to compliance with ILO labour standards, as actions might affect the ILO's promotion of standards. He writes of the creation of special procedures which would consider whether states were taking all the steps necessary to examine the possibility of ILO standards and applying them to the extent which their means and situations allow. The effect of economic growth on these economies would be taken into account in such cases. States would be required to abide by two sets of conditions:[87]

a) They must abide by certain fundamental rights which apply to all countries irrespective of their level of development and which are in fact a pre-condition for social development. These fundamental rights are: freedom of association and the right to organise and bargain collectively, elimination of all forms of forced or compulsory labour, and the effective abolition of child labour and elimination of discrimination in respect of employment and occupation;
b) They must agree to some extent that liberalised trade will go hand in hand with social progress.

Hansenne sees reciprocity as important, stating that the right of developed economies to examine the social situation in developing countries should entail reciprocity, *ie* the renunciation by developing

86 Bhagwati and Hudec, op cit note 12 at 190.

87 Bhagwati and Hudec, op cit note 12 at 121.

countries of the unilateral imposition of trade barriers. He stresses that his proposed procedure would not be an attempt to control social dumping[88] nor an attempt to legislate standardised labour costs.[89]

On the issue of a social clause,[90] the International Labour Office presented a working paper entitled "The Social Dimensions of the Liberalisation of World Trade" to the Governing Body for discussion. The term "social clause" was avoided by the working party because members associated it with the imposition of a certain uniform basis of social protection as a condition of participating in the multilateral trade system. The Working Party, instead of raising the question of whether it is appropriate and possible to impose minimum social protection on everyone, asked what conditions are likely to enable the parties concerned to enjoy an equitable share of the benefits resulting from trade liberalisation, with each country designing in its own way the content of social protection most appropriate to the conditions in their domestic economies.[91]

The concept of equalisation of social costs was rejected, with the Working Party pointing out that while trade liberalisation presupposes a minimum of social harmonisation, equalisation of wages and social protection should not be sought as an end in itself. The extent of social protection should rather correspond to the particulars of each country and, where possible, reflect the free choice of social partners rather than dictation by the international community. The importance of freedom of association for workers[92] in the determination of social policies was emphasised. Regarding the fact that nearly all member states of the ILO are WTO members as well, the working paper states that membership of both organisations means that the states concerned should endeavour in good faith

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88 Social dumping is deemed to occur where countries seek to maintain their competitive position by maintaining substandard conditions and suppressing worker's rights (Hansenne, op cit note 4 at 232-3). An exception would be "identifiable abuses as the exclusion of general social legislation from export processing zones."

89 Bhagwati and Hudec, op cit note 12 at 191.

90 The 1994 discussion of a social clause. Because the ILO has had various discussions on a social clause, this section distinguishes between the various consultations in the interests of achieving greater clarity.

91 Bhagwati and Hudec, op cit note 12 at 192-3.

92 It must be remembered that within the ILO, social partners include workers, employers organisations and the governments.

to take account in each of these organisations of the objectives and obligations they have undertaken in the other.[93]

On the issue of the incorporation of a social clause in the WTO/GATT, the working paper referred to the difficulty of incorporating a social dimension in GATT as this would involve a major new amendment of the texts. Given the substantial modifications of the international trading system[94] and following the conclusion of the Uruguay Round, the need for a near universal consensus, such amendment was unlikely at that time. A better procedure would be the incorporation of the social dimension in the existing GATT order. Three possible scenarios were envisaged in the working paper:[95]

a) considering abnormal social conditions as a subsidy under Article XVI of the GATT. The denial of freedom of association could give rise to the presumption that working conditions are being maintained at abnormally low levels;
b) extending the general exceptions clause (Article XX) of GATT to include workers' rights which have a direct bearing on human dignity;
c) the nullification and impairment clauses of Article XXIV.

While the ILO Working party favoured option (c), nothing further was said on the subject. An ILO press release[96] reported that the Working Party on the Social Dimension of the Liberalisation of International Trade would convene in 1995 on the understanding that the question of trade sanctions and the link between international trade and social standards through a sanctions-based social clause mechanism would be suspended. The Working paper would instead focus its energies on three broad

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93 Bhagwati and Hudec, op cit note 12 at 193-4. Nullification and impairment will be discussed later in this chapter.

94 The Uruguay Round of negotiations began in 1988 and ended only in 1994. Such revisions are time-consuming and fraught with diplomatic, economic and political tensions.

95 Bhagwati and Hudec, op cit note 12 at 223.

96 March/April 1995.

areas:[97]

a) shared values that give political direction to the effort to promote social and economic justice;
b) an examination of the ILO role in helping member states achieve social development through economic growth;
c) a broad discussion of different ways in which to improve the effectiveness of and strengthen the ILO standards supervisory system.

The ILO Commission concluded that it is relatively rare that a non-complying state could be compelled to behave through the application of sanctions. In such cases, it is better to raise the disapproval of the world community, rather than apply concrete sanctions. Only when consultations, negotiations and conciliations have failed should more forceful action be considered. For a fair and effective social clause, clear procedures for consultation are necessary. These procedures should include an investigation of the repercussions on competition, trade and employment of non-adherence to relevant international standards and international assistance to improve conditions. Only in the case of persistent non-cooperation, as a last resort, should a social clause be reinforced by trade sanctions.[98]

In his 1996 speech, Hansenne discussed the reason for the suspension of the discussion in the ILO of mandatory trade sanctions linked to a social clause. He stated that this suspension was linked to a condition that, amongst other things, the Governing Body examine the possibility of introducing this type of special procedure in respect of forced labour and discrimination. The Governing Body has already begun its work in this regard.[99]

Member states and regional groupings which are pro-sanctions, such as the USA and the EU, see the

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97 Bhagwati and Hudec, op cit note 12 at 223.

98 Van Liemt, op cit note 77 at 446.

99 Hansenne, op cit note 85 at 236.

ILO's continual adoption of its conciliatory and supervisory approach as its weakness. Continual reference is made to the success of the social component of the USA GSP[100] scheme which has been in place since 1985. Countries wanting to be part of the USA GSP scheme are required to take steps to give workers internationally-recognised workers' rights, including freedom of association, the right to collective bargaining, a prohibition against forced labour, a minimum work age and acceptable conditions at work related to wages, hours, health and safety. These steps do not refer specifically to ILO Conventions.[101] The USA GSP system relies on a blanket tariff waiver, which is withdrawn if countries default on their labour undertakings. Trade unions usually petition the USA Administration, claiming non-compliance by governments of the provisions of the USA legislation. From 1985 to1995 approximately 34 countries were named in petitions of labour rights abuses under the USA GSP laws. While most petitions were dismissed, where petitions were accepted, normal procedure resulted in the countries concerned being given time to change their behaviour. Of the 101 workers' petitions filed, preferences were withdrawn or suspended in only 12 cases. This indicates that peer pressure is an effective form of enforcement, as extended reviews increase transparency and apply pressure to reneging governments. The threat of the loss of preferences is also an important coercive measure.[102] Trade unionists in countries under GSP review believe that their governments have reacted more positively to criticisms in the GSP petition than they have ever reacted to the negative judgment by the ILO's Committee on Freedom of Association.[103]

The linkage of trade with labour provisions has convinced pro-sanction proponents that the WTO would be an appropriate forum for pursuing a social clause. This linking of labour standards to the GSP scheme also provides an example of how labour standards could be linked to trade and enforced through the GATT Dispute Settlement mechanism. There remain many inbuilt difficulties in adopting this approach. The biggest problem is that it allows for a unilateral enforcement of labour standards,

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100 United States of America Generalised System of Preferences Scheme.

101 The USA has ratified very few of these Conventions.

102 Oxfam (1996:62-63).

103 For more on the US GSP scheme and the EU Social Chapter and Generalised System of Preferences (GSP). See Oxfam, op cit note 102 at 60-64. See also Tan and Reeves, op cit note 7 at 31-34.

with governments using trade preferences as bait. No mention has been made of the criteria utilised in disciplining defaulting states or whether states are given any aid in the adoption of these measures. While there can be no doubting the effectiveness of this method, it places incredible power in the hands of the more dominant states who may, themselves, be in default. This approach also works on the premise that developing countries alone have poor labour practices.

Higher wages do not necessarily represent a clean labour record as higher pay does not mean that workers enjoy freedom of association or that there is no discrimination on the basis of race, gender or political association. While problems of forced and child or prison labour are more likely to be found in countries which are poorer or have poor human rights records, issues such as freedom of association and discrimination are prevalent in all states and are not contingent upon the level of development. The danger of linking labour standards to market entry is that it effectively prevents developing countries from addressing poor labour standards in their more powerful benefactor states. Despite its no trade sanctions stance, the ILO provides a much fairer means of dealing with labour issues. Through the tripartite, secret ballot system, all states have a say, with the interests of trade unions, workers organisations and governments being represented. While the issue of trade sanctions remains uncertain, the fact that ILO Working Groups have considered this option and are currently discussing it, provides some hope that the ILO may still develop into the powerful organisation the pro-sanctions lobby seeks.

4.4.2 The General Agreement on Tariffs and Trade (GATT) and a social clause

Although the only tie which the WTO really has with labour issues is the draft Havana Charter of 1948, the WTO/GATT has been deemed to be an appropriate forum for the adoption and supervision of minimum international labour standards. The Havana Charter was negotiated during the 1946-48 period together with the General Agreement on Tariffs and Trade (GATT) as part of the proposed International Trade Organisation (ITO) which never came into being. Through the Havana Charter, Members hoped to introduce fair labour standards to the ITO and thus provide a link between trade and labour.[104]

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[104] Bhagwati and Hudec, op cit note 12 at 198.

Within the Havana Charter, Members recognised that:[105]

a) all countries have a common interest in the achievement and maintenance of fair labour standards regarding productivity and therefore the improvement of wages and working conditions as productivity permits. Members recognised that unfair labour conditions, especially in the production of export goods, created difficulties in international trade. Members would accordingly take whatever action was deemed appropriate and feasible to eliminate such conditions within their territories;

b) Members who were also members of the ILO could cooperate with the ILO in giving effect to this undertaking;

c) in all matters relating to labour standards that could be referred to the ILO, the ITO would consult and cooperate with the ILO.[106]

As the ITO fell away, GATT remained an agreement dealing mainly with trade issues, in particular, trade in commodities and later trade in services. With subsequent GATT rounds, the scope of the GATT was generally extended to include measures which are, strictly speaking, not true trade issues eg environmental issues and intellectual property rights.[107] With the adoption of these ancillary disciplines, it has been argued that labour standards, as a trade-related issue, should be included as well. The question of what trade-related issues are has been influenced by the inclusion of the above-mentioned non-trade measures, making the categorisation of trade-related issues a matter of opinion, rather than fact. The adoption of minimum labour conditions within the WTO has been linked to Article XX (the general exceptions clause), Article XVI (subsidies) and Article XXIII (nullification and impairment clause). These will be discussed below.

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105 Loc cit.

106 For more on the Havana Charter, see Van Dijk and Faber, op cit note 11 at 248-9.

107 Other issues include competition policy, investment policy, government procurement and services. See Bhagwati and Hudec, op cit note 12 at 199-202.

4.4.2.1 Labour provisions and Article XX

Article XX is often seen as the most logical link between trade and labour as it permits Member states to impose barriers to trade where these measures are deemed necessary to:[108]

a) protect public morals (Article XX)
b) protect human, animal or plant life or health (Article XX (b));
c) protect against the products of prison labour (Article XX (e)).

The Preamble to Article XX is deemed to guard against protectionism as it declares that the general exceptions are not to be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or as a disguised restriction on international trade. The linking of labour issues to the Article XX provisions while deemed convenient, could be slightly problematic. While Article XX(a) provides for the protection of human morals, the question to be asked here is whether minimum labour standards can be called moral standards. Morality has often been raised to justify the adoption of a social clause, with the notion of competitive advantage sometimes being seen as morally illegitimate.[109] The human rights argument put forward here is that forced labour, for example, is to be prevented not because it is inefficient but because it is wrong, in that it violates a fundamental principle of equal humanity, which holds that all individuals are entitled to equal concern and respect.[110] The morality argument could therefore be used to condemn low labour costs on the assumption that low costs are linked to a disregard for human rights. A strength of the human rights argument is that it moves away from the claim for a level playing field by accepting that there are flaws in the marketplace brought about by a denial of fundamental and universal rights.[111]

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108 WTO (1994:519).

109 Van Dijck and Faber, op cit note 11 at 39.

110 Langille, op cit note 17 at 20.

111 Langille, op cit note 17 at 25.

Acceptance of core labour rights by the ILO and its member states provides a way to deal with human rights concerns without excluding economic efficiency concerns. Within the area of labour provisions, equal treatment which is enforced through trade sanctions may exacerbate the fate of those the WTO seeks to help. From a trade perspective, where there is nothing wrong with another country's labour policies, differences alone should not be deemed to matter as they would form part of a country's cost advantage. This argument differs significantly from the position of moral relativism adopted by the Burmese government which defended its lax labour standards on grounds that labour standards differ because of different cultures, economic conditions and analytical beliefs and theories concerning moral consequences of specific labour standards. The argument of moral relativism merely enables countries to avoid the real issues surrounding labour rights by defending the very atrocities which core labour standards seek to address. Despite the values-related or morality[112] argument, for a practice to be against public morals, it should be universally condemned, with no rational reason being available to justify the practice.[113] Low labour standards cannot be deemed immoral just because they are not comparable with the higher labour standards of industrial countries. Standards are to be judged on a case-by-case basis as the levels of development (both legal and economic) achieved by states influences the standards of labour adopted by governments. A distinction can clearly be drawn between labour standards which are intentionally being suppressed and standards which correspond to the economic and social realities of a particular society. Because there are often rational reasons for low labour standards, they cannot be deemed universally unacceptable. Article XX(a) is therefore not a suitable provision to use for incorporating labour standards into a trade context.

A more popular option is a link between labour and Article XX(b) which provides for trade barriers where measures are "necessary to protect human, animal or plant life and health". This is the provision most often invoked for the protection of the environment. In its 1990 Report on "*Thailand-Restrictions on Importation of and Internal Taxes on Cigarettes*",[114] the Panel noted that for a

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112 The word "moral" is defined as "concerned with right or wrong conduct" (Hawkins, 1991:332).

113 Van Dijck and Faber, op cit note 11 at 39-40.

114 DS10/R, adopted on 7 November 1990, 37S/200. In this case, the Panel examined measures by Thailand prohibiting imports of cigarettes from the USA.

measure to be covered by Article XX(b) it had to be necessary. The Panel noted that in the 1987 Panel Report on "*Japan-Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*"[115] the Panel had concluded that a contracting party cannot justify a measure inconsistent with other GATT provisions as necessary if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it.[116]

Given that Article 4 of the Singapore Ministerial Declaration declares the ILO to be a competent body to set and deal with core labour standards, WTO Member states would first have to exhaust their options under the ILO before they can bring trade measures against offending countries, through Article XX(b). Because of the ILO's reluctance to promote trade sanctions as an option, a question would have to be raised as to the interpretation of the phrase "actions deemed wise and expedient to secure compliance", as employed by the ILO. Parties would therefore have to prove to a GATT Panel that they had exhausted all other means of ensuring compliance with core labour standards and that trade restrictions are necessary. Another question raised here is how trade sanctions taken to enforce core labour standards are necessary to protect human, animal or plant life and health. While it is easy to link environmental standards to the protection of human, animal or plant life or health, it is more difficult to link core labour standards to human life or health, except perhaps where forced labour has resulted in death or health problems. Examples include forced labour in unprotected mines or chemical factories or, as in the case of Myanmar,[117] where the mortality rate for labour is high due to labourers having to carry unusually heavy goods. Only very specific cases could be dealt with in terms of Article XX(b). It could therefore not be used as a link to the general labour clause.

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115 L/6216, adopted on 10 November 1987, 34S/83.

116 The GATT Article XX(b) can therefore only be invoked where countries have no alternative means of ensuring the aims of the provision. Because Article XX makes allowances for trade sanctions, this is probably the way in which WTO Member states would seek to go. The question which WTO Panels would have to answer is whether such action is actually necessary *ie* whether all other avenues for bringing resolution to the issue been exhausted.

117 For more on Myanmar and the treatment of forced labour, see Perspectives, (1998:396-398).

Article XX(e), which deals with the adoption or enforcement by any contracting party of measures relating to the products of prison labour cannot be extended to encompass products of forced labour as prison labour is not synonymous with forced labour. This provision is not suitable for the enforcement of other core labour conditions, however, as it makes no provision for aid, supervision and conciliatory monitoring. A case in point is child labour. While it is necessary to decrease and finally abolish child labour in developing countries, the use of trade sanctions alone is only likely to worsen the position of these children without providing welfare benefits.[118]

Apart from the limited application of Article XX, the ILO has objected to its use as it permits countries to impose unilateral barriers to trade on the basis of their own assessment. This opens the door to possible abuse of trade barriers for protectionist reasons on the basis of the exceptions permitted under Article XX.[119] Bhagwati,[120] on the issue of unilateral actions, states that there is nothing in the GATT to compel a government to overturn a unilateral decision once taken. The party undertaking the unilateral action can persist in a violation while making a compensatory offer of an alternative trade concession or the offended party can retaliate by withdrawing an equivalent trade concession. Given the unequal bargain positions between developed and developing countries, such retaliatory action is unlikely to occur. With the costs of increased imports from developing to developed economies, some developed countries would probably gain more than they lose in such a position.

4.2.2.2 Subsidies and core labour standards

Article 5 of the Agreement on Subsidies and Countervailing Measures[121] states that "no Member

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118 The issue of child labour will be dealt with in detail in the sub-section on trade sanctions.

119 Van Dijck and Faber, op cit note 12 at 204.

120 Bhagwati and Hudec, op cit note 11 at 44.

121 WTO, op cit note 108 at 268.

should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1,[122] adverse effects to the interests of other Members *ie*:

a) injury to the domestic industry of another Member;
b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, in particular the benefits or concessions bound under Article II of GATT 1994; or
c) serious prejudice to the interests of another Member.

The link between subsidies and trade is provided by the argument on fairness. Hudec[123] has drawn a distinction between offensive unfairness and defensive unfairness claims. With offensive unfairness, it is claimed that the domestic policies adopted by governments in the exporter's countries of origin provide them with unfair advantages when competing in importing country or third-country markets. Defensive unfairness is deemed to occur when a country has adopted policies that unfairly favour its own products and unfairly penalise foreign producers wishing to sell into the home country's market. It is often argued that weak labour laws operate as implicit subsidies to firms located in countries with such policies and give them an artificial advantage in export markets. Through the Agreement on Subsidies and Countervailing Measures,[124] countries could take action against those deemed to be artificially deflating their labour prices. The problem with this approach is that countries would once again be able to take unilateral action against developing countries with below minimum core labour standards. No room appears to be left for differences in economic development between the least-developed countries and advanced and middle-income economies. Because no two developing countries are at exactly the same stage of economic development, there are no set rules which measure the rate of progress in the adoption of core labour standards or specify which implementation problems are acceptable within a developing country context. There is therefore no real way of determining when a country may be experiencing implementation problems

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122 Paragraphs (a) and (b) of Article 1, Agreement on Subsidies and Countervailing Measures, specifies when a subsidy shall be deemed to exist, WTO, op cit note 108 at 264.

123 Trebilcock and Howse, op cit note 26 at 214-215.

124 Loc cit.

and when a country is deliberately suppressing the cost of labour. With the issue of labour standards, it would be easy to overlook the comparative advantage gained by developing countries rich in both natural resources and cheap unskilled labour. Countries blessed with both are more likely to export their goods at prices lower than competing developed country exporters. It cannot therefore be assumed that countries with the lowest prices are always guilty of unfairly subsidising their exports.

Articles XXII and XXIII of the GATT 1947 provided the original means of determining default by other contracting parties and provided these states with a rudimentary means of solving disputes. Article XXIII is important as it provides the guidelines for determining when states have reneged on their GATT undertakings. Generally, states can seek redress where the action of a particular state has the effect of nullifying or impairing any benefit which may have accrued to the non-defaulting state had the defaulting state fulfilled its obligations Articles XXII and XXIII remain an integral part of the WTO dispute settlement mechanism[125] with Article XXII being considered as a means of incorporating labour standards into the GATT process.

4.4.2.3 Article XXIII of the GATT (nullification or impairment) and labour standards

Given the difference in the effects of child, forced or prison labour on prices and the effect of the lack of freedom of association or discrimination, unfair labour practices, though present, may not necessarily have the effect of subsidising labour costs. This is quite apparent when determining the effect of gender as opposed to race discrimination. Women and black people will normally be paid less than white males doing the same work. In some cases, however, low paid jobs may be reserved for white males who will then be paid more than black males doing the same job.[126] Industries with a gender bias can inevitably be deemed to be subsidised where females are predominantly employed. This cannot be assumed to be the case for race discrimination as low-skilled white workers will be preferred over black workers, resulting in sectors with higher wages than normal. In this case, higher prices are indicative of unfair labour prices. Higher prices are therefore not to be accepted as a

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125 WTO, op cit note 108 at 405.

126 Posner (1972:214-21, 294-97).

barometer of labour health. This remains true for freedom of association as well, because government interference and control of union power does not necessarily reflect in the wages paid to workers. The subsidies route is too simplistic in that it does not allow for any real analysis of markets but, instead, provides room for states to identify, on an individual basis, what constitutes a labour subsidy, thus reopening the protectionist problem.

Article XXII (1) reads as follows:[127]

> "If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as a result of:
>
> a) the failure of another contracting party to carry out its obligations under this Agreement,
> b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
> c) the existence of any other situation,
>
> the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it."

Where contracting parties are unable to reach a satisfactory outcome within a reasonable time, or where the difficulty is brought about by the existence of any other situation,[128] the matter may be referred to the Contracting Parties. The Contracting Parties will promptly investigate any matter referred to them and make appropriate recommendations to the relevant contracting parties, the

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127 WTO, op cit note 108 at 521.

128 As envisaged by Article XXIII(1)(c). Prior to the formation of the WTO, participants were known as contracting parties. When all states acted together as the GATT council, they were referred to as the Contracting Parties.

Economic and Social Council of the United Nations and any appropriate inter-governmental organisation in cases where such consultation is considered necessary. Where the Contracting Parties consider the circumstances to be serious enough to justify such action, they may authorise a contracting party or parties to suspend the application of any other contracting party or parties of such concessions or other obligations under this Agreement as they deem to be appropriate in the circumstances. Where the application to any contracting party of any concession or other obligation is in fact suspended, this contracting party has sixty days after the action is taken to give written notice to the Executive Secretary of the Contracting Parties of its intention to withdraw from this Agreement. Withdrawal will take effect on the sixtieth day following the day on which such notice is received by the Executive Secretary.[129]

The ILO considers this provision to be the appropriate link to labour issues, as, unlike Article XVI, it does not permit the injured party to mete out justice itself or attempt to restore balance by applying restrictions which would not normally be allowed to apply.[130] Article XXIII (2) permits contracting parties to refer the matter to the appropriate forum, in this case the ILO, for consideration. Parties are prevented from taking unilateral action under this Article. Given the reference in Article 4 of the Singapore Ministerial Declaration (1996) to the ILO as the appropriate forum for labour dispute, it is most likely that labour disputes raised under Article XXIII will be referred to the ILO for adjudication. In this way, parties can be assured of the dispute being considered in the correct context. While this process may be acceptable to the ILO, it is doubtful whether pro-sanction proponents would accept it, given that it provides a means for states to avoid trade sanctions.

Even though Article XXIII may be a correct means of enforcing the labour provisions, the question remains as to how the social clause will be adopted by the GATT . So far, methods of enforcement have been considered. For enforcement methods to apply, however, the provisions being considered must be GATT provisions. Without the adoption by Member states of an agreement on labour standards, however, Article XXIII cannot be used for enforcement of these provisions. In a Panel

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129 Article XXIII (2), WTO, op cit note 105 at 521-22.

130 Bhagwati and Hudec, op cit note 12 at 194-5.

Report on "*Canada Administration of the Foreign Investment Review Act*"[131] delegates expressed doubts about whether the dispute between the United States and Canada was one for which the GATT had competence, as it involved investment legislation, a subject not covered by the GATT. Representatives of both Canada and the USA reassured the Panel that only trade matters within the purview of GATT would be examined. The Council then decided that the terms of reference should remain as they stood, with the reservations and statements being placed on the record and that it be presumed that the Panel would be limited in its activities and findings to within the confines of GATT.

The assumption that the GATT Panels will apply elements other than relevant GATT provisions is one which parties cannot make in the context of Article XXIII. In a Panel on "*EEC-Quantitative Restrictions against Imports of Certain Products from Hong Kong*"[132] the EEC argued that the Panel could not ignore that the General Agreement was an international agreement which had to be interpreted on the basis of generally accepted principles and practices of international law. The Panel considered the EEC argument that the principle referred to as "the law-creating force derived from circumstances" could be relevant in the absence of law. It found that in the relevant case the situation did not exist, and the matter was to be considered in the light of the provisions of the General Agreement. This finding was reiterated in the 1990 Panel Report on "*EEC Payments and Subsidies Paid to Processors and Producers of Oil Seeds and Related Animal-Feed Proteins*".[133] The Panel Report noted that the Panel was established to make findings in the light of the relevant GATT provisions. It therefore did not have the mandate to propose interpretations of the Subsidies Code which the community invoked to justify its position. The Panel Report in 1987 on "*United States - Taxes on Petroleum and Certain Imported Substances*"[134] went further. The EC argued here that the border tax adjustments involving the tax on certain imported chemical substances were inconsistent

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131 L/5504, adopted on 7 February 1984, 30S/140, 141, para 1.4 referring to C/M/162, p25-26. WTO (1995:643-4).

132 L/5511, adopted on 12 July 1983, 30S/129, 134, para 15, WTO, op cit note 130 at 732.

133 L/6627, adopted on 25 January 1990, 37/S131, WTO, op cit note 130 at 733.

134 L/6175, adopted on 16 June 1987, 34S/136, 162, para 5.2.6, WTO, op cit note 130 at 732.

with the polluter-pays principle adopted in the OECD.[135] The Panel stated that its mandate was to examine the case before it in the light of the relevant GATT provisions. The Panel Report noted the existence of the Group on Environmental Measures and International Trade, and stated that the EC would thus have a forum available in the GATT in which to pursue the environmental issues which the Panel, because of its limited mandate, could not address.

These rulings raise difficult questions, as parties have to realise that the GATT is bound by principles separate from those adopted by other international fora, be they environmental or labour. Parties must ask themselves whether they would want their disputes to be decided purely using trade principles or whether the ILO would not be the best forum for the settlement of labour disputes. As the matter rests, the GATT has not adopted labour provisions, apart from the direct application of Article XX(e). It is doubtful whether a GATT Panel would be prepared to rule on purely labour issues, be they within the context of Articles XXIII or XVI, unless these issues were raised in the context of more relevant GATT issues. For a fair and just adjudication of core labour standards within a multilateral framework, the ILO appears to be a better option than the GATT.

4.3 Is the WTO the appropriate forum for labour issues?

While the ILO remains the official labour forum, increased pressure is being placed upon Member states to accept labour rights as part of the GATT agenda. The acceptance of a social clause is being seen as the only way to ensure that labour standards are effectively implemented and enforced. While efficient implementation and enforcement is a worthwhile goal, the forum chosen must also be fair. The question raised within this context, therefore, is which forum (the ILO or the GATT) is most likely to be fair to all Member states. In order to determine fairness, the following questions will be asked:

a) Can a rational connection be made between the particular forum and the adoption of labour standards?

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135 Organisation for Economic Cooperation and Development.

b) Would the adoption of labour standards within the relevant forum be proportional *ie* do the ends sought to be realised justify the means employed?

c) Would the adoption of labour standards within the particular forum be efficient, both legally and economically?

d) Does the particular forum address the power imbalance amongst states?

There is, within the context of the ILO, a legitimate connection between the adoption of core labour rights and the primary purpose of the ILO. Because the ILO (as the official labour body) focuses directly on labour issues, core labour rights are already on its agenda, as is the question of trade sanctions. The ILO also has the infrastructure needed to ensure the efficient and effective implementation of labour rights. With the adoption of a social clause by the GATT, the issue is not as clear cut. While the Uruguay Round resulted in the incorporation of trade-related issues into the GATT, the GATT/WTO is still predominantly a trade organisation. In the Singapore Declaration, Member states have pledged their support for the ILO and have recognised the ILO as the legitimate labour body. Where states seek the incorporation of a social clause into the GATT Agreement, their motives may not necessarily be pure. The GATT, because it enables states to determine outcomes through trade sanctions, is seen as necessary to ensure bilaterally that trading partners abide by their labour obligations. The lack of power to force states to implement their labour obligations has resulted in the ILO being seen as an ineffective organisation. While the ILO has not provided Member states with the option of trade sanctions, this is a step which it has been seriously considering.

On the question of a rational connection, a legitimate connection can be made between the ILO and core labour standards, or even a social clause. In terms of a social clause being incorporated into the GATT, the fact that the GATT provides for trade sanctions is not a legitimate reason for labour issues to be transferred to the GATT, despite the fact that the ILO already exists. There is also the question of whether the GATT has the necessary infrastructure to deal adequately with labour issues. Given that core labour standards are already advocated by the ILO, the GATT is only able to provide for the possibility of enforcement of trade sanctions. While it has been argued that developing states have responded more readily to threats by trading partners who have sought higher labour standards

through threats of reducing access to their markets, the bilateral enforcement of labour standards through sanctions or the elimination of preferential market access gives some states too much power over their trading partners. From the point of rationality, while the need for a more efficient enforcement system is a legitimate and relevant concern, this is not sufficient reason to give up on the ILO without giving it an opportunity to provide for more effective enforcement methods. While the GATT provides for enforcement through trade sanctions, it does not have the necessary support structure for the adoption of core labour standards on a case-by-case basis. Despite the enforcement structure provided by the GATT, there is no rational connection between the adoption of a social clause by GATT Member states and a legitimate goal.

The next question is one of proportionality, that is, do the ends sought justify the means utilised? While core labour standards are common to both the ILO and the argument for a social clause, the point of difference is the use of trade sanctions to force governments to comply. While the ILO has refused to allow the use of trade sanctions, in 1999 the ILO excluded Myanmar from its proceedings because of the latters persistent use of forced labour. In December 2000, it allowed the imposition of sanctions for the same reason. ILO Members were therefore required to review their dealings with Myanmar to ensure that they were not contributing towards the continued use of forced labour.[136] While the ILO's stance on trade sanctions for Myanmar does not mean that the organisation has changed its overall position on trade sanctions, its recent actions have resulted increased activism. This increased activism, together with the recent improvements in information and communications technologies and increased NGO activity, has made the naming and shaming strategy of the ILO more effective, making the ILO a much stronger force in raising labour standards.[137]

While mention has been made of core labour standards as referred to by the ILO, there is no way of telling just which labour standards will be incorporated into the GATT and the impact of blanket provisions on individual economies. Another question is that of the impact of trade sanctions on individual economies. Within the ILO, with its focus on individual states and their unique

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136 McCulloch, Winters and Cicera (2001:311).

137 McCulloch et al, op cit note 136.

requirements, implementation of core labour standards occurs at the discretion of individual governments, with states choosing how and when to implement individual labour standards. ILO Member states are also provided with the support necessary to ensure their effective implementation.

This is something lacking in the argument for a social clause. Where the emphasis is on trade sanctions and the speedy implementation of labour standards, the needs of individual states are likely to be neglected. Where bilateral imposition of trade sanctions occurs, it is probable that the developing countries will be targeted, given that they have very little leverage. Unlike the ILO, which allows for multilateral discussion of problems encountered by individual states, sanctions within the GATT context are dependent upon the judgment of an individual state. Where sanctions are threatened, it is likely that countries will comply, regardless of the economic effects of compliance, especially where states are dependent on the economic goodwill of more powerful trading nations. The impact of sanctions on the nations being targeted and, in particular, the victims of labour abuses is not certain, with research showing that trade sanctions, depending on the method of application, could harm as much as it can help the victimised groups. Where trade sanctions alone are utilised to promote higher labour standards, the costs of higher labour standards may be more than the benefits derived by victimised groups. Within the context of the GATT, a social clause is not proportional as the means employed are not justified by the ends sought. The approach taken by the ILO is much more balanced and proportional, as it focuses on both the impact on individual states and the goal of higher labour standards.

A question which has been raised within the context of labour rights is one of efficiency. From a legal viewpoint, labour standards must be part of a larger agenda. In addition to seeking higher labour standards, there must be some steps taken to address the problems experienced by developing economies. Where possible, the relevant forum should provide for redress. Within the context of the ILO, a hands-on approach has been taken, with the ILO working directly with all interested parties in ensuring satisfactory outcomes. While this approach has not always worked effectively, it has protected individual states from outside interference and given developing economies greater say over the method and of implementing labour provisions. The secret ballot method operating within the ILO means that the developing economies may vote against more established developed states

where they have not complied with ILO provisions or are in contravention of ratified conventions.

This is unlikely to occur within the GATT context because of the way the dispute settlement body has been set up. An issue which may work against developing country interests within the GATT context is the way in which arguments for higher labour standards have been structured. While some valid economic arguments exist, most calls for higher labour standards are based on the assumption that low labour standards occur mainly within developing economies. Because the assumption exists that developing economies alone are defaulting on labour standards, it is unlikely that these economies will be given much room to manouevre, or that developed economies will seek to help developing economies by either providing technical assistance or opening their markets to developing country goods. The reasoning behind the social clause does not leave much hope for prospects of redress or aid to be provided to developing economies. While the ILO fares much better, it does not have the power to compel developed economies to assist their developing country counterparts in ways which signify redress. Both the ILO and the GATT do not therefore provide for legally efficient outcomes.

On the question of economic efficiency, the effectiveness of trade sanctions has to be questioned. McCulloch *et al*[138] are of the opinion that linking trade and core labour standards in the WTO will raise compliance with such standards because of the effective threat of trade sanctions. The positive effects of trade sanctions are likely to be overwhelmed by negative spillovers, however, as for many developing economies, growth through greater integration in the global economy is an important means of pursuing poverty reduction. Trade sanctions could therefore be highly destructive. There is also the possibility of trade sanctions being exploited by wealthier states for protectionist reasons. Experience has shown that once legal provisions for discriminatory action are available, they tend to be extensively used. A link between trade and labour, while it may ensure higher labour standards, may also provide for discriminatory behaviour and enable developed states to protect their economies further against developing economy goods. This is not an economically efficient outcome.

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138 McCulloch et al, op cit note 136 at 313.

While a direct link does not exist between ILO Member states and achieving higher labour standards, a more aggressive enforcement policy which results in higher labour standards could only benefit Member states, especially developing country Members. Where developing countries implement labour standards in a manner which is beneficial to their individual economies without outside pressure, there are economic benefits to be reaped. Because states are adopting higher labour standards, they will be able to avoid protectionist pressures and, all other things being equal, achieve greater access to developed markets. Even where greater access to developed markets is not guaranteed, higher labour standards, if properly implemented, will contribute towards increased welfare within individual states. The ILO could, with a more aggressive and proactive approach, contribute to increased economic efficiency.

On the question of power, the ILO has provided developing economies with a forum in which they can raise and deal with their labour concerns without fear of coercion by developed states. While it may be argued that it is the power given to developing economies which has contributed towards the ineffectiveness of the ILO, the fact that developing economies are able to raise issues and vote against defaulting developed economies without fear of reprisal is a positive development. If a social clause is incorporated into the GATT, it is unlikely that the developing economies will have the security which they enjoy within the ILO. Bilateral action and the ability to implement trade sanctions will probably mean that developing economies and their interests will be at the mercy of developed country goodwill and judgment. Without the protection of a secret ballot, developing economies many not be able to address developed country shortcomings without fear of reprisals. Without economic strength, it is unlikely that trade sanctions imposed by individual developing economies will have much effect on much larger developed economies. While trade sanctions will therefore empower developed economies within the GATT context, the same may not be said of developing economies, who rely on access to developed markets. Where a social clause is adopted by the GATT, it is therefore more likely to entrench existing imbalances amongst developed and developing states, rather than remove them. On the issue of fairness, the incorporation of a social clause within the GATT framework is most likely to result in unfair outcomes for developing economies. While the ILO does not provide for proper redress amongst states or really efficient outcomes, developing economies are more likely to be treated fairly within the ILO. The ILO is

therefore a much better choice for developing economies than the GATT.

4.4 Conclusion

While higher labour standards will benefit workers in both developed and developing economies alike, the adoption of a social clause is not the best option. Though trade sanctions provide a means of ensuring that states comply with their labour obligations, the trade-labour link also provides states with a means of protecting their own economies, using higher labour standards as an excuse. Within the ILO, states are given more equal status, with the emphasis placed upon individual state interests and needs rather than the blanket implementation of labour standards, regardless of the effects of the implementation of these standards on individual states, and especially on developing economies. While the trade-labour link may provide for more effective implementation of labour standards, it also provides a way for developed states to discriminate unfairly against developing states. Although the ILO has, in the past, not been very effective in enforcing labour standards, the recent stance taken on Myanmar suggests that trade sanctions may be a tool which ILO states are prepared to use where other methods of enforcement fail. Even if the ILO is not open to indiscriminate application of trade sanctions, the fact that this is an option which may be considered, together with the more benign approach taken on enforcement, may provide the ILO with the leverage it needs to be more effective. This, together with the infrastructure which the ILO provides, makes it a much better and fairer forum for securing higher labour standards.

Chapter 5

Dispute Settlement in the WTO

5.1. Introduction

Prior to the formation of the World Trade Organisation (WTO), dispute settlement within the GATT occurred without many legal guidelines and inspired very little confidence amongst contracting parties. Dispute settlement operated within a rudimentary legal framework and was for the most part consensus-based. In this chapter the dispute settlement process prior to the WTO will be discussed together with the problems which the lack of proper legal procedure caused. Of relevance to this thesis is the impact of WTO resolutions on developing economies. While the lack of proper legal regulation was of concern to all contracting parties, especially those states without sufficient bargaining power, the consensus-based system caused problems which were applicable to all states. Issues which have more relevance to developing states are trade negotiations and the follow-up procedure within the WTO. These will be discussed in depth to identify problems of particular significance for developing economies.

5.2 Problems experienced before and after the formation of the dispute settlement process

Before the adoption of the WTO Understanding on Rules and Procedures governing the Settlement of Disputes,[1] the GATT dispute settlement process inspired very little confidence among contracting parties. Criticisms were particularly levelled against the delay and uncertainty of the process, the absence of the right to a panel, and the lack of time limits on consultations, responses to requests for panels, panel proceedings and rulings. Parties were also concerned about the absence of legal procedure and clarity in panel rulings. There was also uncertainty about panel rulings being adopted,

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1 WTO (1994:404-407). Also known as the DSU.

given that the consent of the losing party was necessary for doing so.[2] Lack of consensus amongst contracting parties could result in a delay in and partial or non-complete compliance with panel rulings. Prior to the adoption of the WTO dispute settlement forum, the GATT dispute settlement process had been used primarily by developed countries, with seventy-three percent of all complaints being filed by the USA, the EU, Canada and Australia, and ninety-two percent of all complaints involving the USA or the EU (or its members) as a Party.[3]

In the 1980s the panel process became more ineffective, with increasing secrecy in panel proceedings and the way in which panel rulings were developed and drafted, and long delays in the de-restriction of the rulings and related documents. Panellists under the GATT system were generally not experts in international trade law or distinguished jurists of any kind. They were mostly junior or middle-level trade diplomats, or retired trade diplomats, generally without formal legal training, who were expected to take advice from the GATT Secretariat. The GATT Secretariat also played a crucial role in selecting names for appointment to panels. While the dispute settlement process therefore appeared to be impartial, disinterested juridical decision-making by a panel of experts, in reality, the process was dominated by a small, closely-knit technocratic elite with a professional interest in maintaining the GATT as a regime dominated by liberal trade values. Panel reports were only de-restricted when adopted, and reports which were not adopted by the contracting parties were not de-restricted. Where panel reports were de-restricted, they were published only much later in the official reporting service (BISD), making it difficult for academics and other independent jurists to obtain documents if they did not have good relations with members of the GATT Secretariat.[4]

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2 The setting up of a panel and the adoption of its report required consensus in the GATT Council (which was made up of all states). For a panel report to be adopted, the consensus of all GATT states was necessary. It was therefore possible for the state whose actions were challenged to block effective action, (Merrills 1998:200).

3 While this could primarily be attributed to the composition of the GATT prior to the formation of the WTO, a secondary consideration would be the lack of weight which developing countries had within the GATT, (Trebilcock and Howse, 1999:55-56).

4 Trebilcock and Howse, op cit note 3 at 57-58.

The ability of states to block the setting up of a dispute resolution panel and the adoption of its reports through the consensus requirement was a significant weakness of the GATT dispute resolution process as were the arrangements necessary for securing the implementation of panel decisions. Because the various GATT and Tokyo Round Agreements contained different substantive rules and different arrangements for dispute settlement, states could partake in both "norm shopping", *ie* seeking the most favourable rule, and "forum shopping", *ie* seeking the most favourable procedure.[5]

An issue which has been carried over to the WTO is the basis of the dispute settlement process. Throughout the history of the GATT, and to a lesser extent the WTO, Members have been ambivalent about the appropriate role of dispute settlement procedures. Some parties favoured a negotiation or diplomacy-oriented approach whereby dispute settlement procedures were not legalistic but simply assisted negotiators to resolve differences through negotiation and compromise. The approach favoured by parties over the decades has been a more legalistic one. As the GATT dispute settlement process has matured, parties have come to view the procedure as a relatively disciplined juridical process by which an impartial panel could make objective rulings about whether states' activities were consistent with their GATT obligations.[6] The rule-oriented approach, as it is known, has considerable advantage. By focusing the attention of the disputing parties on rules and the application of these rules, parties are forced to pay more attention to the rules of the GATT and their obligations thereunder. This in turn leads to greater certainty and predictability, elements which are essential to global economic affairs driven by market-oriented principles of decentralised decision-making, with millions of entrepreneurs participating therein. Those entrepreneurs need some predictability in global markets, and guidance in order to make appropriate and efficient investment and market development decisions.[7] The USA viewed the GATT and now the WTO treaty texts as vitally important to improving a rule-oriented international economic system which enhances the predictability and stability of the circumstances of international commerce. The basic goal of a rule-

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5 Merrills, op cit note 2.

6 For the evolution of the GATT dispute settlement process and the movement from the diplomacy-oriented approach to a rule-oriented approach, see Jackson (1998:64-70).

7 Jackson, op cit note 6 at 60-61.

oriented approach is the reduction of risk associated with trade between nations with vastly differing governmental and cultural structures.[8]

The WTO has introduced major innovations to deal with the numerous shortcomings of the GATT dispute settlement process. A unified dispute settlement system has been established for all parts of the WTO, including the subjects of services and intellectual property. This system eliminates the ability of states to norm or forum shop. All relevant matters and arguments by relevant parties can now be considered in a particular dispute case. The new Dispute Settlement Understanding (DSU) reaffirms and clarifies the right of a complaining government to have a panel process initiated. Blocking at the stage of implementation of a panel or the adoption of a panel report has now been prevented. The DSU has established a unique new appellate procedure which will substitute some of the former GATT Council procedures. A panel report will now effectively be deemed adopted by the new Dispute Settlement Body (DSB), unless one of the parties to the dispute appeals. If a panel report is appealed, the dispute is referred to the Appellate Body. When the Appellate Body has ruled, the report returns to the DSB. It will then be deemed to have been adopted unless there is consensus against adoption.[9] As a result, panel reports will come into force as a matter of international law in virtually all cases.[10]

The WTO dispute settlement system is rule-oriented. Jackson[11] has suggested that there are two ways in which to analyse this system: by the implementation of the DSU rules and through the actual practice and the cases. Article 3(2)[12] states that the WTO dispute settlement system is a central element in providing security and predictability to the multilateral trading system. Members recognise that it serves to preserve their rights and obligations under the covered agreements, and to

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8 Jackson, op cit note 6 at 77.

9 Articles 16 and 17, Understanding on Rules and Procedures Governing the Settlement of Disputes, WTO, op cit note 1 at 417-419.

10 Merrills, op cit note 2. Jackson, op cit note 6 at 72.

11 Jackson, op cit note 6 at 97.

12 Annex 2, Understanding on Rules and Procedures governing the settlement of disputes, WTO, op cit note 1 at 405. (Hereafter referred to as Annex 2).

clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. The recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements. This article is consistent with a rule-oriented approach, as are the provisions relating to first-stage panels and appellate review.[13] This strong rule-oriented approach has been a source of criticism against the new dispute settlement regime. Participating governments now find that they have to be more legalistic in their advocacy, to the extent that they have to seek non-government expertise to assist them in cases. Some diplomats have found it necessary to take much greater account of the dispute settlement procedures in their negotiations, with a threat to initiate the dispute settlement process being seen as a worthwhile bargaining chip. This is unsettling to traditional diplomats, who worry that their power to defend their country's interests has been diminished or put into the hands of lawyers rather than diplomats or politicians. This has led to concerns for national sovereignty. Jackson suggests that some of the following are relevant to the sovereignty question:[14]

1.1 the type of people selected as panellists and their prior experience;

1.2 the lack of interim measures in the WTO dispute procedures, which is deemed to weaken the international system;

1.3 the DSU language which warns against changing the rights and obligations of Members;

1.4 the obligation to perform rather than merely compensate;

1.5 the relative lack of remedies such as monetary compensation or refunds of inadequately performed duties.

These questions, while jurisprudential, can have importance for issues of sovereignty, weakening the international system and benefiting national sovereignty or, on the contrary, leading to a strengthening of the international system.[15]

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13 Article 11 to Article 22, Annex 2, WTO, op cit note 1 at 413-425.

14 Jackson, op cit note 6 at 99.

15 Jackson, op cit note 6 at 98-99.

Besides the issue of sovereignty, the DSU has experienced some teething problems. While the DSU is designed to provide a single unified dispute settlement procedure, parties to each of the plurilateral agreements may make decisions regarding dispute settlement procedures and how the DSU may or may not apply.[16] Together with exceptions for certain listed texts, the goal of uniformity of dispute settlement procedures may not be completely achieved. Another problem is the question of resource allocation needed for the dispute resolution process. While a reasonable amount of resources were allocated to the dispute settlement process and the Appellate Body, projections for the near future suggest that there is a possibility of the case load of these bodies outstripping allocated resources. Whereas the GATT Council dealt with approximately 150 disputes between 1947 and 1995,[17] from 1995 to May 1998 137 complaints had already been initiated under the new dispute settlement process. Any projection made based on the previous dispute settlement record would therefore have been too modest.[18] The elimination of the blocking mechanism whereby parties had to consent to the implementation of a panel or the adoption of panel reports has been criticised by some diplomats and critics of the WTO system, who view the new system as being too automatic and tougher than the procedures of the GATT Council. Criticism has also been targeted at the secrecy of the WTO procedures, the lack of opportunity of private groups such as non-governmental organisations to offer views and evidence, the possible conflict of interest of the panellists and the possibility that WTO Secretariat lawyers may be biased and could possibly have too much influence on the panels and appeals.[19]

Criticisms of the DSU and the WTO dispute settlement process do not appear to be characterised by a North-South divide, as these criticisms have been general in nature. Unlike with the dispute

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16 Appendix 1 (c), Annex 2, WTO, op cit note 1 at 429-430. This provision provides "that the applicability of the Understanding to the Plurilateral Trade Agreements shall be subject to the adoption by the parties to each agreement setting out the terms for the application of the Understanding to the individual agreement, including any special or additional rules or procedures for inclusion in Appendix 2 as notified to the DSB." Appendix 2 refers to special or additional rules and procedures contained in the covered agreements.

17 Merrills , op cit note 2.

18 Jackson, op cit note 7 at 73.

19 Jackson , op cit note 7 at 76.

settlement process under that GATT Council, the WTO dispute settlement process is more widely used by developing countries, who have also used it against other developing countries.[20] The ability of these countries to bring disputes against offending Members, especially developed country Members without fear of retaliation from the offending nations is an essential condition for a just dispute settlement forum, as is the inability of more powerful Members to take coercive unilateral measures against poorer, less powerful developed and developing countries because of the presence of a legitimate functioning dispute settlement process. The provisions of the WTO dispute settlement forum will be examined to determine whether it provides the less-advantaged Members with a fair and just hearing and gives these countries an equal chance of success, depending on the legitimacy of their complaints.

5.3 WTO dispute settlement procedures

5.3.1 General provisions

Article 1(1) of the Understanding on Rules and Procedures governing the settlement of disputes[21] provides that the rules and procedures of this Understanding will apply to disputes brought pursuant to the consultation and dispute settlement provisions of the covered agreements listed in Appendix 1 of the Understanding.[22] The rules and procedures of the Understanding also apply to consultations and the settlement of disputes between Members concerning their rights and obligations under the provisions of the WTO Agreement and of the Understanding taken in isolation or in combination

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20 Examples of such cases are: *Guatemala-Anti-Dumping Investigation Regarding Imports of Portland Cement from Mexico* (WT/D560); *Turkey - Restrictions on Imports of Textile and Clothing Products*, complaint by India (WT/D534); *Ecuador - Provisional Anti-dumping Measure on Cement from Mexico*, complaint by Mexico (DS 182/1) and *South Africa - Anti-Dumping Duties on the Import of Certain Pharmaceutical Products from India*, complaint by India (WT/DS 168/1). See also Jackson, op cit note 6 at 74.

21 WTO, op cit note 1 at 404.

22 Appendix 1 refers to the Agreements covered by the Understanding. These are the Agreements establishing the World Trade Organisation, the Multilateral Trade Agreements; including the Agreement on Trade in Goods, GATS, the Agreement on TRIPS and the Understanding on Rules and Procedures governing the settlement of disputes and the Plurilateral Trade Agreements. WTO, op cit note 1 at 429.

with any other covered agreement. The Dispute Settlement Body (DSB) has been established to administer the rules and procedures of the Understanding and, except as otherwise provided in a covered agreement, also the consultation and dispute settlement provisions of the covered Agreements. The DSB therefore has the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorise suspension of concessions and other obligations under the covered agreements. Where disputes arise under covered agreements which are Plurilateral Trade Agreements, the term "Member" shall refer only to those Members that are parties to the relevant Plurilateral Trade Agreements.[23] When the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that agreement may participate in decisions or actions taken by the DSB with respect to that dispute. Where the rules and procedures of the Understanding provide for the DSB to take a decision, it must do so by consensus.[24]

Members are still bound by the principles for the management of disputes applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures which have been elaborated and modified by the Understanding.[25] Prior to the adoption of the Understanding, Article XXII and XXIII had provided the basis for the GATT dispute settlement process. An issue raised under Article XXIII was that relating to the burden of proving nullification or impairment. The 1962 Panel Report on "*Uruguay on Recourse to Article XXIII*" noted that here there is a clear infringement of the provisions of the General Agreement. A clear infringement would occur where measures are applied in conflict with the provisions of GATT and are prohibited by the relevant protocol under which the GATT is applied by the contracting party, the action would, *prima facie*, constitute a case of nullification or

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23 Article 2(1), Annex 2, WTO, op cit note 1 at 405.

24 Article 2(4), Annex 2, WTO, op cit note 23. Footnote 1 of the Understanding on Rules and Procedures governing the settlement of disputes states that the DSB shall be deemed to have decided by consensus on a matter submitted for its consideration if no Member, present at the meeting of the DSB when the decision is taken, objects formally to the proposed decision.

25 Article 3(1), Annex 2, WTO, op cit note 23. Article XXII refers to consultation between Contracting Parties on matters affecting the operation of the GATT 1947, while Article XXIII deals with the provisions for nullification or impairment. See WTO, op cit note 1 at 521.

impairment.[26] The "Agreed Description of the Customary Practice of the GATT in the field of Dispute Settlement" annexed to the "Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance" of 28 November 1979[27] provides that in practice, contracting parties have had recourse to Article XXIII only when in their view a benefit accruing to them under the GATT has been nullified or impaired. In cases where an infringement of the GATT obligation occurs, the action is considered *prima facie* to constitute a case of nullification or impairment. A *prima facie* case of nullification or impairment would *ipso facto* require consideration of whether the circumstances are serious enough to justify the authorisation of suspension of concessions or obligations, if the contracting party bringing the complaint so requests.

There is normally a presumption that a breach of the rules has an adverse impact on other contracting parties and, in such a case, it is up to the contracting party against whom the complaint has been brought to rebut the charge.[28] Articles XXII and XXIII are still highly relevant as the Understanding applies only to new requests for consultation under the consultation provisions of the covered agreements made on or after the date of entry into force of the WTO Agreement. With respect to disputes for which the requests for consultation were made under GATT 1947 or under any other predecessor agreement to the covered agreements prior to the date of entry into force of the WTO Agreement, the relevant dispute settlement rules and procedures in effect immediately prior to the date of entry into force of the WTO Agreement continue to apply.[29]

Article 3(8)[30] refers to the burden of proof where an action is deemed *prima facie* to constitute a case of nullification or impairment. As under the GATT, it is up to the Member against whom the complaint has been brought to rebut the charge. In the Appellate Body Report on "*United States* -

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26 L/1923, adopted on 16 November 1962, 115/95, 99-100, para.15, (WTO 1995:655).

27 L/4907, adopted on 28 November 1979.

28 L/4907, adopted on 28 November 1979, 265/216, para. 5. WTO, op cit note 26.

29 Article 3 (11), Annex 2, WTO, op cit note 1 at 407. Footnote 2 of the Understanding provides that this paragraph will also be applied to disputes on which panel reports have not been adopted or fully implemented.

30 Annex 2, WTO, op cit note 1 at 406.

Measures affecting Imports of Shirts and Blouses from India"[31] the Appellate Body addressed the allocation of the burden of proof in detail in the context of the Agreement on Textiles and Clothing, stating that Article 3(8) of the DSU provides that in cases where there is an infringement of the obligations assumed under a covered agreement - that is, where a violation is established - there is a presumption of nullification or impairment. The Member against whom the complaint has been brought must rebut this presumption. The issue in this case is which party has the burden of demonstrating that there has been, or has not been, an infringement of the obligations assumed under Article 6 of the Agreement on Textiles and Clothing.

In addressing the issue, the Appellate Body found it difficult to see how any system of judicial settlement could work if it incorporated the proposition that the mere assertion of a claim might amount to proof. It is therefore not surprising that various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. It is a generally accepted canon of evidence that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence.[32] If that party produces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it produces evidence sufficient to rebut the presumption. In the context of the GATT 1994 and the WTO Agreement, precisely how much and what kind of evidence will be required to establish such a presumption will necessarily vary from measure to measure, provision to provision, and case to case.[33] On the issue of quantum of proof, Vermulst *et al* are of the opinion that while plaintiffs have to show that a violation occurred, and not simply rely on a presumption that this is the case, there is no legal security as to the amount of evidence needed to satisfy the presumption threshold.[34]

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31 WT/DS33/AB/R (25 April 1997).

32 *Soward v Leggatt* (1836) 7C and P, p 613. See also *Woolmington v Director of Public Prosecutions* (1935) A.C 462 at pp. 481, 482, *Stocks v Stocks (Pty) Ltd v TL Daly and Sons (Pty) Ltd* 1979 (3) SA 754 (A) and *Pillay v Krishna* (1946) AD 946 at 951-52.

33 WT/DS 33/AB/R (25 April 1997) at pp 13-14. Vermulst, Mavroidis and Waer (1999:10-11).

34 Vermulst et al, op cit note 33 at 10.

Article 3(2) of the Understanding provides that Members recognise that the Understanding serves to preserve the rights and obligations of Members under the covered agreements, and to clarify customary rules of interpretation of public international law. Palmeter and Mavroidis[35] have classified WTO sources of law as WTO Panel and Appellate Body reports, GATT Panel reports, customary rules of interpretation of public international law, particularly Articles 31 and 32[36] of the Vienna Convention on the Law of Treaties, teachings of the most highly qualified publicists, general principles of law and other international instruments, such as agreements referred to in the WTO Agreements and Agreements between the parties concerned. In the Appellate Body Report on "*Japan - Taxes on Alcoholic Beverages*"[37] the Appellate Body confirmed that adopted panel reports are an important part of the GATT *acquis*[38] and are often considered by subsequent Panels. They create legitimate expectations among WTO Members, and should therefore be taken into account where they are relevant to any dispute. They are not binding, however, except with respect to resolving the particular dispute between the parties to that dispute. Their character and legal status have not been changed by the coming into force of the WTO Agreement. Unadopted Panel reports have no legal status in the GATT or WTO systems as they have not been endorsed through decisions by the contracting parties to the GATT or WTO Members. A Panel could however find useful guidance in the reasoning of an unadopted Panel report that it considered to be relevant.[39]

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35 Vermulst et al, op cit note 33 at 16.

36 Article 31 refers to the general rule of interpretation ie "a treaty should be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" (Article 31(1)). Article 32 refers to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: a)
leaves the meaning ambiguous or obscure; or b) leads to a result which is manifestly absurd or unreasonable, (Dixon and McCorquadale, 1991:73).

37 WT/DSB/AB/R, WT/DS10/AB/R, WT/D11/AB/R (4 October 1996).

38 Acquired possession. In this instance, it would translate as acquired law, (Niermeyer 1976:17).

39 WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (4 October 1996) at pp 14-15.

In "*United States - Standards for Reformulated and Conventional Gasoline*"[40] the Appellate Body stated that the general rule of interpretation, Article 31, has attained the status of a rule of customary or general international law. As such, it forms part of the customary rules of interpretation of public international law, which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the GATT and other covered agreements of the WTO Agreement. This direction reflects a measure of recognition that the GATT is not to be read in clinical isolation from public international law.[41]

The issue of legitimate expectation in the context of the customary rules of interpretation of public international law was discussed by the Appellate Body in "*India - Patent's Protection for Pharmaceutical and Agricultural Chemical Products*".[42] In its report, the Appellate Body rejected the first Panel's[43] application of Article 31, stating that the Panel misunderstood the concept of legitimate expectation in the context of the customary rules of interpretation of public international law. The legitimate expectation of the parties to a treaty are reflected in the language of the treaty itself. The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the Vienna Convention. These principles of interpretation neither require nor condone the imputation into a treaty of concepts that were not intended.[44] In "*Japan - Taxes on Alcoholic Beverages*" the Appellate Body held that there can be no doubt that Article 32 of the Vienna Convention, which deals with the role of supplementary means of interpretation, has also attained the status of a rule of customary or general international law.[45] On the issue of academic publications, references thereto in Appellate Body reports were made mostly in the first reports. Academics referred

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40 WT/D52/AB/R (29 April 1996).

41 WT/D52/AD/R (29 April 1996), at p 17, (Vermulst et al, op cit note 33 at 17).

42 WT/DS50/AB/R (19 December 1997).

43 WT/D550/R (5 September 1997).

44 WT/D550/AB/R (19 December 1997) at para. 45.

45 WT/DS10/AB/R, WT/DS11/AB/R, WT/D58/AB/R (4 October 1996) at 10.

to are usually in the field of international public law rather than trade law experts.[46]

Before bringing a case, a Member must exercise its judgment as to whether action under these procedures would be fruitful.[47] This provision can be linked to the observation that WTO rules are designed to create competitive opportunities, not actual trade. In *"European Communities - Regime for the Interpretation, Sale and Distribution of Bananas"*, the Appellate Body rejected the EU argument that the USA must have a legal interest in the sense of a narrowly-defined trade interest to bring a case. It noted that there was no legal interest requirement in the DSU, stating that Article XXIII of GATT 1994 and Article 3(7) of the DSU made it clear that a Member has broad discretion in deciding whether to bring a case against another Member under the DSU. The language of Article XXIII(1) of GATT 1994 and of Article 3(7) of the DSU suggests, further, that a Member is expected to be largely self-regulatory in deciding whether any such action would be fruitful. With the increased interdependence of the global economy, Members have a greater stake in enforcing WTO rules than in the past, as any deviation from the negotiated balance of rights and obligations is more likely than ever to affect them, directly or indirectly.[48]

The aim of the dispute settlement mechanism is to secure a positive resolution to a dispute which is mutually acceptable to the disputing parties and consistent with the covered agreements. Where there is no mutually acceptable solution, the first objective of the dispute settlement mechanism is usually to ensure the withdrawal of the measures concerned if they are found to be inconsistent with the provisions of any of the covered agreements. Compensation should be sought only if the intermediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. As a last resort, a Member invoking the dispute settlement procedures may suspend the application of concessions or other obligations under the covered agreements on a discriminatory basis *vis-a-vis* the other Member, subject to authorisation

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46 Vermulst et al, op cit note 33 at 18.

47 Article 3(7), Annex 2, WTO, op cit note 1 at 406.

48 WT/DS27/AB/R (9 September 1997), at para 134-136 (Vermulst et al, op cit note 33 at 2).

by the DSB.[49] Requests for conciliation and the dispute settlement procedures should not be intended or considered as contentious acts. If a dispute arises, all Members must engage in these procedures in good faith in an effort to resolve the dispute. Complaints and counter-complaints in regard to distinct matters should not be linked.[50] Notwithstanding paragraph 11,[51] if a complaint based on any of the covered agreements is brought by a developing country Member against a developed country Member, the complaining party has a right to invoke, as an alternative to the provisions of Article 4, 5, 6 and 12 of the Understanding,[52] the corresponding provisions of the Decision of 5 April 1966,[53] except where the Panel considers that the time-frame provided for in paragraph 7 of the Decision is insufficient to provide its report. The Decision deals with the situation where consultations between a less-developed country and a developed country in regard to any matter falling under paragraph 1 of Article XXIII do not lead to a satisfactory settlement. The less-developed party may refer the matter to the Director-General so that, acting in an *ex officio* capacity, he may use his good offices with a view to facilitating a solution. Because abuse of GATT measures can cause severe damage to the trade and economic development of the less-developed contracting parties, the Decision of 5 April 1966 seeks to facilitate the resolution of such situations while taking fully into account the need for safeguarding both the present and potential trade of less-developed contracting parties affected by such measures. With the agreement of the complaining party, the time-frame may be extended. Where there is a difference between the rules and procedures of Articles 4,5, 6 and 12 and the corresponding rules and procedures of the Decision, the latter shall prevail.

From the general provisions governing the functioning of the DSB, it is evident that a more rule-oriented approach has been taken to the settlement of disputes between states. Reference to public

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49 Article 3(7), Annex 2, WTO, op cit note 45.

50 Article 3(10), Annex 2, WTO, op cit note 1 at 407.

51 See footnote 29 and related material.

52 These are the provisions on consultations, good offices, conciliation and mediation, establishment of panels and panel procedures respectively.

53 B15D 145/18. WTO, op cit note 26 at 641-2.

international law and reliance on established legal customs, as in the accepted rules for determining burden of proof or interpretation of statutes, provides more legal certainty and clarity to the DSB. Incorporation of international rules and custom also gives more weight to DSB panel reports, even though they are not binding. The adoption of a more legalistic attitude towards dispute settlement has had positive implications for less powerful states. Adoption of the international rules of determining proof means that states cannot utilise the threat of disciplinary action to dominate less powerful states where there is no actual infringement of a GATT provision. By placing the onus of proof on the plaintiff, the DSB ensures that only real infringements of GATT provisions are dealt with. Developing or other less powerful states are therefore not forced to defend themselves in cases where the plaintiff has no evidence of infringement. In the case of disputes between developed and less-developed states, the fact that the less-developed state may refer the matter to the Director-General where it achieves a less than satisfactory outcome, may ensure that developed states do act in good faith and with proper concern for the growth and development needs of less-developed economies. While not much, this provision provides less-developed states with a measure of security in their consultations with developed states.

5.3.2 Consultations

Members have undertaken to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former.[54] When a request for consultation is made in accordance with a covered agreement, the Member to whom the request is made must, unless otherwise mutually agreed, reply to the request within 10 days after the date of receiving the request and shall enter into consultation in good faith within a period of no more than 30 days after receiving the request. If the Member does not respond within 10 days after receiving the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receiving the request, the Member that requested the

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54 Article 4(2), Annex 2, WTO, op cit note 1 at 407-8, where provisions of any other covered agreements conforming to measures taken by regional or local governments, or authorities within the territory of a Member contain different provisions from those in this paragraph, the provisions of the other covered agreement will prevail.

holding of consultations may proceed directly to request the establishment of a panel.[55]

During consultations Members must give special attention to the particular problems and interests of developing country Members.[56] Members other than the consulting Members with a substantial trade interest in consultations being held according to paragraph 1 of Article XXII of GATT provisions in other covered Agreements may notify the consulting Members and the DSB within 10 days after the date of the circulation of the request for consultations, of its desire to be joined in the consultations.[57] If the Member to which the request for consultation is addressed agrees that the claim of substantial interest is well-founded, the interested Member may join the consultations. In this case, the parties must inform the DSB. Where the request to be joined in the consultations is not accepted, the applicant Member is free to request consultations under paragraph 1 of Article XXII or paragraph 1 of Article XXII of GATS, or the corresponding provisions in other covered Agreements.[58]

The issue of the composition of panels is an important one. Article 8 (1)[59] provides that panels must be composed of well-qualified governmental and/or non-governmental individuals, including persons who have served on or presented a case to a panel, served as a representative of a Member or of a contracting party of GATT 1947 or as a representative to the Council or Committee of any covered agreement or its predecessor agreement, or in the Secretariat, taught or published on international trade law or policy, or served as a senior trade policy official of a Member. Panel Members must be selected with the aim of ensuring the independence of the Members, a sufficiently diverse background and a wide spectrum of experience.[60] Citizens of Members whose governments are parties to the

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55 Article 4(3), Annex 2, WTO, op cit note 1 at 408.

56 Article 4(10), Annex 2, WTO, op cit note 1 at 409.

57 Article 4(1), Annex 2, WTO, op cit note 1 at 409.

58 Loc cit. Article XXIII of GATS refers to dispute settlement and enforcement. Article XXIII(1) provides that "if any Member should consider that any other Member fails to carry out its obligations or specific commitments under GATS, it may with a view to reaching a mutually satisfactory resolution of the matter have recourse to the DSU." (WTO, op cit note 1 at 346).

59 WTO, op cit note 1 at 411.

60 Article 8(2), op cit note 1at 411.

dispute or third parties as defined by paragraph 2 of Article 10[61] shall not serve on a panel concerned with that dispute, unless the disputing parties agree otherwise.[62]

Panels will be composed of three panellists unless the parties to the dispute agree, within 10 days from the establishment of a panel, to a panel composed of five panellists. Members shall be promptly informed of the composition of the panel.[63] The Secretariat shall propose nominations for the panel to the disputing parties who may not oppose nominations except for compelling reasons.[64] Members have undertaken, as a general rule, to permit their officials to serve as panellists.[65] Panellists must serve in their individual capacities and not as government representatives, nor as representatives of any organisation. Members must therefore not give them instructions nor seek to influence them as individuals with regard to matters before a panel.[66] When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests, include at least one panellist from a developing country Member.[67] Panellists' expenses, including travel and subsistence allowance, shall be met from the WTO budget[68]

Provision has been made for both multiple complaints and third party interest. Where more than one Member requests the establishment of a panel related to the same matter, a single panel may be established to examine these complaints taking into accounts the rights of all Members concerned. A

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61 A third party is any Member having a substantial interest in the matter before a panel and who, having notified the DSB of its interest, should have an opportunity to be heard by the panel and to make written submissions to the panel.

62 Article 8(3), op cit note 1 at 411. Footnote 6 provides that in the case where customs unions or common markets are parties to a dispute, this provision applies to citizens of all Member countries of the customs union or common market.

63 Article 8(5), Annex 2, WTO, op cit note 1 at 412.

64 Article 8(6), Annex 2, WTO, op cit note 1 at 412.

65 Article 8(8), Annex 2, WTO, op cit note 1 at 412.

66 Article 8(9), Annex 2, WTO, op cit note 1 at 412.

67 Article 8(10), Annex 2, WTO, op cit note 1 at 412.

68 Article 8(11), Annex 2, WTO, op cit note 1 at 412.

single panel should be established to examine if such complaints are feasible.[69] The single panel must organise its examination and present its findings to the DSB in such a manner that the rights which the disputing parties would have enjoyed had a separate panel examined the complaints, are in no way impaired. Where one of the parties to the dispute so requests, the panel shall submit separate reports on the dispute concerned. A complainant may present its written submissions to the panel when any one of the other complainants presents its views to the panel.[70] Where more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panellists on each of the separate panels and the timetable for the panel process with such disputes must be harmonised.[71] The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute must be fully taken into account during the panel process.[72]

The function of the panels is to assist the DSB in discharging its responsibilities under the Understanding and the covered agreements. A panel should accordingly make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity of the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels must regularly consult with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution.[73] Panel procedures should provide sufficient flexibility so as to ensure high quality panel reports, while not unduly delaying the panel process.[74] In order to make the procedures more efficient, the period in which the panel conducts its examination, from the date that the composition and terms of reference of the panel have been agreed upon until the date the final report is issued to the parties to the dispute, shall, as a general rule, not exceed six months.

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69 Article 9(1), Annex 2, WTO, op cit note 1 at 412.

70 Article 9(2), Annex 2, WTO, op cit note 1 at 413.

71 Article 9(3), Annex 2, WTO, op cit note 1 at 413.

72 Article 19 (1), Annex 2, WTO, op cit note 1 at 413.

73 Article 11, Annex 2, WTO, op cit note 1 at 413.

74 Article 12 (2), Annex 2, WTO, op cit note 1 at 414.

In cases of urgency, including those relating to perishable goods, the panel must aim to issue its report to the disputing parties within three months.[75] If the panel considers that it cannot issue its report within six months, or within three months in cases of urgency, it must inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will issue its report. In no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months.[76] Where consultations involve a measure taken by a developing country Member, the parties may agree to extend the periods established in paragraphs 7 and 8 of Article 4. If, after the relevant period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB will decide, after consultation with the parties, whether to extend the relevant period and, if so, for how long. In addition, in examining a complaint against a developing country Member, the panel shall allocate sufficient time for the developing country Member to prepare and present its argumentation.[77] Where one or more of the parties is a developing country Member, the panel's report must explicitly indicate the manner in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members. Panellists are to be guided by provisions of the covered agreements raised by the developing country Members in the course of the dispute settlement procedures.[78]

While limited to the provisions for special and differential treatment for developing economies, the fact that panellists must account for their treatment of developing country interests is important as it means that panellists must be forever mindful of the impact of the findings on the economies of developing states. More importantly, mindfulness of the limitations and problems faced by developing economies in carrying out their GATT obligations may ensure that these countries are not forced to over commit themselves. Panellists, being trade, legal or economic experts, will be in a good position to determine what may be expected of the developing economies and so balance the interests of both sides fairly. The fact that panellists are limited to the provisions of the actual agreements means that

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75 Article 12(8), Annex 2, WTO, op cit note 1 at 414.

76 Article 12(9), Annex 2, WTO, op cit note 1 at 415.

77 Article 12 (10), Annex 2, WTO, op cit note 1 at 415.

78 Article 12 (11), Annex 2, WTO, op cit note 1 at 415.

provisions which impact negatively on developing economies will be enforced. Panellists cannot, however, be given broader discretion, as WTO Member states are not, as yet, fully committed to a completely autonomous, rules-based, dispute settlement system. The fact that multiple complaints or third party interests are allowed may also benefit developing countries, especially smaller developing economies which do not have sufficient resources or the legal expertise to put forward a solid argument. Where developing countries, as a group, have a complaint against a more powerful state, the multiple complaint system will benefit all interested parties and enable more organised developing states to assist their poor, less organised fellow states to seek redress. Groups of states dealing with the same issue will also find it easier to pool resources and obtain good legal counsel.

Each panel has the right to seek information and technical advice from any individual or body which it deems appropriate. A Member must respond promptly and fully to any request by a panel for such information which the panel considers necessary and appropriate. Confidential information which is provided must not be revealed without formal authorisation from the individual, body, or authorities of the Member providing the information.[79] Panels may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter. Where a factual issue concerning a scientific or other technical matter is raised by a party to a dispute, a panel may request an advisory report in writing from an expert review group.[80]

In "*United States - Import Prohibition of Certain Shrimp and Shrimp Products*", the Appellate Body ruled that *amicus curiae* briefs are allowed. The Appellate Body provided that

> "authority to seek information is not properly equated with a prohibition on accepting information that has been submitted without having been requested by a panel. A panel has the discretionary authority either to accept and consider or to reject information and advice submitted to it, whether requested by a panel or not. The fact that a panel may *motu proprio* have initiated the request for information does not, by itself, bind the panel to accept and consider the information which is actually submitted. The amplitude of authority vested in

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79 Article 13(1), Annex 2, WTO, op cit note 1 at 416.

80 Article 13(2), Annex 2, WTO, op cit note 1 at 416.

panels to shape the processes of fact-finding and legal interpretation makes it clear that a panel will not be obliged, as it were, with non-requested materials, unless that panel allows itself to be so deluged".[81]

This judgment has been widely criticised, especially by developing countries, on both legal and systemic grounds. The main legal objection is that the Appellate Body, after often having emphasised the importance of literal and textual interpretation, now veers away from the plain meaning interpretation of the word "seek" and overextended itself in order to include submission of unsolicited NGO briefs. The systemic argument is that the Appellate Body decision potentially grants NGOs, not parties to the dispute, more rights than WTO Members.[82] On the issue of advice from experts, the Appellate Body in "*European Communities - Measures affecting Meat and Meat Products*" held that both Article 11(2) of the Sanitary and Phytosanitary Agreement and Article 13 of the DSU enable panels to seek information and advice as they deem appropriate in a particular case.[83]

The WTO law limits access to dispute settlement procedures to government officials of Member states of the WTO. Under public international law, however, the issue of who can represent a government is a question of domestic administrative or constitutional law. As a result, a government is free to have a private attorney as a member of its delegation appearing before a WTO adjudicating body. The WTO organs will have to respect such a decision.[84]

5.3.4 Appellate review

The proceedings of the Appellate Body are confidential. The reports of the Appellate Body must be drafted without the presence of the parties to the dispute and in the light of the information provided

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81 WT/DS58/AB/R (12 October 1998) at para. 99.

82 Vermulst et al, op cit note 33 at 3.

83 WT/DS26/AB/R, WT/D548/AB/R (16 January 1998), at paras 146-147.

84 Vermulst et al, op cit note 33 at 4-5.

and statements made.[85] An Appellate Body report must be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the report within 30 days following its circulation to the Members. The adoption procedure does not deprive Members of the right to express their views on an Appellate Body report,[86] but there may be no *ex parte* communications with the panel or Appellate Body.[87] Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it will recommend that the Member concerned bring the measure into conformity with that agreement. The panel or Appellate Body may also suggest ways in which the Member concerned brings the measure into conformity with the agreement. The panel or Appellate Body may also suggest ways in which the Member concerned could implement the recommendations.[88] The panel and Appellate Body cannot, in the finding, add to or diminish the rights and obligations provided in the covered agreements.[89]

Unless otherwise agreed to by the parties to the dispute, the period from the date of establishment of the panel by the DSB until the date the DSB considers the panel or Appellate report for adoption must, as a general rule, not exceed nine months where the panel report is not appealed or12 months where the report is appealed.[90] Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.[91] Particular attention should be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to dispute settlement.[92] Except where the panel or the Appellate Body has extended the time for providing its report, the period from the date of establishment of the panel by the DSB until the date of determination of the reasonable period of time

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85 Article 17(10), Annex 2, WTO, op cit note 1 at 419.

86 Article 17(14), Annex 2, WTO, op cit note 1 at 419.

87 Article 18(1), Annex 2, WTO, op cit note 1 at 419.

88 Article 19(1), Annex 2, WTO, op cit note 1 at 420.

89 Article 19(2), Annex 2, WTO, op cit note 1 at 420.

90 Article 20, Annex 3a, WTO, op cit note 1 at 420.

91 Article 21, Annex 2, WTO, op cit note 1 at 420.

92 Article 21(2), Annex 2, WTO, op cit note 1 at 420.

must not exceed 15 months unless the parties to the dispute agree otherwise. Where either the panel or the Appellate Body has acted to extend the time of providing its report, the additional time will be added to the 15 month period. Except where the parties to the dispute agree that these are exceptional circumstances, the total time shall not exceed 18 months.[93]

The DSB shall keep under surveillance the implementation of adopted recommendations or rulings. Unless the DSB decides otherwise, the issue of implementation of the rulings and recommendations will be placed on the agenda of the DSB meeting after six months following the date of establishment of the reasonable period of time[94] and shall remain on the DSB's agenda until the issue is resolved. At least 10 days before each such DSB meeting, the Member concerned must provide the DSB with a status report in writing of its progress in the implementation of the recommendations or rulings.[95] If the matter has been raised by a developing country Member, the DSB must consider what further action it might take which will be appropriate to the circumstances.[96] Where a case is brought by a developing country Member, the DSB, in considering what appropriate action might be taken, must taken into account both the trade coverage of measures complained about and their impact on the economy of developing country Members concerned.[97]

Where the recommendations and rulings of the panel and Appellate Body are not implemented within a reasonable period of time, compensation and the suspension of concessions or other obligations are temporary measures available. Neither compensation nor the suspension of concessions or other

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93 Article 21(4), Annex 2, WTO, op cit note 1 at 421.

94 Article 21(3) provides that a reasonable period of time shall be:
a) "a period of time proposed by the Member concerned, provided that this period is approved by the DSB. In the absence of such approval,
b) a period of time mutually agreed by the parties to the dispute within 45 days after the date of adoption at the recommendations and rulings;
c) a period of time determined through binding arbitration within 90 days after the date of adoption at the recommendations and rulings, a reasonable time should not exceed 15 months from the date of adoption of a panel or Appellate Body report, the time may, however, be shorter or longer, depending on the particular circumstances.

95 Article 21(b), Annex 2, WTO, op cit note 1 at 422.

96 Article 21(7), Annex 2, WTO, op cit note 1 at 422.

97 Article 21(8), Annex 2, WTO, op cit note 1 at 422.

obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, must be consistent with the covered agreements.[98] Article 22(3)(a) to (c) provides the principles and procedures to be applied when considering what concessions and other obligations to suspend. In applying these principles, a party must take into account:[99]

"a) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification and impairment, and the importance of such trade to that party;

b) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations. The level of the suspension of concessions or other obligations authorised by the DSB must be equal to the level of the nullification or impairment."[100]

The suspension of concessions or other obligations must be temporary and must be applied only until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. The DSB will, in accordance with paragraph 6 of Article 21, continue to keep under surveillance the implementation of adopted recommendations or rulings, including those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented.[101]

The DSU has also provided special procedures for least-developed country Members. Article 24(1) provides that particular consideration must be given to the special situation of least-developed country Members at all stages of the determination of the causes of a dispute and of dispute

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98 Article 22(1), Annex 2, WTO, op cit note 1 at 422.

99 Article 22(3), Annex 2, WTO, op cit note 1 at 423.

100 Article 22(4), Annex 2, WTO, op cit note 1 at 423.

101 Article 22(8), Annex 2, WTO, op cit note 1 at 425.

settlement procedures involving a least-developed country Member. In this regard, Members must exercise due restraint in raising matters under these procedures involving a least-developed country Member. Where nullification or impairment is found to result from a measure taken by a least-developed country Member, complaining parties must exercise due restraint in asking for compensation or seeking authorisation to suspend the application of concessions or other obligations relating to these procedures. Where a satisfactory solution to a dispute settlement case involving a least-developed country Member has not been found in the course of consultations, the Director-General or the Chairman of the DSB shall, upon request by a least-developed country Member, offer their good offices, conciliation and mediation in an effort to assist the parties to settle the dispute, before a request for a panel is made. The Director-General or the Chairman of the DSB, in providing assistance, may consult with any source which it deems appropriate.[102]

Appellate Body proceedings, as with consultations and panel proceedings are much speedier, with emphasis being placed on obtaining an efficient resolution of matters. This development is in direct response to the complaint which Members made about dispute settlement prior to the DSB, when panels could drag on for years because of countries' intentional stalling of the proceedings. Despite the emphasis on faster, more efficient dispute resolution, room has been made for developing economies, where they need more time to mount a legal defence. Even where provision is made for developing country concerns, such as more time to prepare a legal case, greater concern for the impact of GATT provisions on developing country economies or for countries bringing disputes against developing countries to proceed with caution, everything has to occur within a specific context or time frame. The DSB seeks conciliatory outcomes and imposes sanctions as a last resort, to be used when all other means of resolution fail. In addition, the DSB is committed to monitoring the progress of Member states in implementing its rulings. The hands-on approach adopted by the DSB has given Members, both developed and developing, new confidence in its ability to bring about speedy and fair outcomes. Through effective monitoring, states are assured that sanctions may truly be a last resort, with countries being unable to use the threat of sanctions to achieve desired outcomes.

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102 Article 24(2), Annex 2, WTO, op cit note 1 at 426.

5.4 Article 17(6) of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994

Article 17(6) provides that the DSB panel, in examining the matter referred to in paragraph 5,[103] must determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned.[104] The panel must interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of pubic international law. Where the panel finds that a relevant provision of the Agreement leaves room for more than one permissible interpretation, the panel must find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.[105]

Article 17(6) differs from the general DSU approach to dispute resolution as it limits the authority of WTO panels and confers greater power into the hands of domestic governments. This has raised the issue of sovereignty, in the sphere of anti-dumping legislation. Parties seeking greater sovereign control within the WTO suggested that the international rules of procedure should restrain WTO panels from ruling against a nation if its approach or interpretation was reasonable. This suggestion was opposed on two grounds by Member states. Many nations felt that such a rule would overly constrain panels while giving too much leeway to national governments to act in a manner inconsistent with the purposes of the WTO Agreements. Others felt that a "reasonable" standard would allow different nations to develop different approaches to the international rules of the WTO Agreements, thus reducing consistency and reciprocity, and potentially allowing many different national administrative versions of the same treaty language. Parties also believed that the

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103 Article 17(5)(1) provides that the DSB must, at the request of the complaining party, establish a Panel to examine the matter based on a written statement of the Member making the request indicating how a benefit accruing to it directly or indirectly, under the Agreement has been nullified or impaired, or that the achieving of the objectives of the Agreement is being impeded (WTO, op cit note 1 at 192).

104 WTO, op cit note 1 at 193.

105 Article 17(6)(ii), op cit note 1at 193.

"reasonableness criteria" would constrain panels too much, and make it difficult to successfully challenge objectionable practices that were inconsistent with WTO rules.[106] Croley and Jackson[107] have commented on the issue of sovereignty and the standard-of-review question, stating that the standard-of-review question is faced at least implicitly whenever sovereign Members of a treaty yield interpretive and dispute settlement powers to international panels and tribunals. As national economies become more interdependent, and the need for international cooperation and coordination accordingly becomes greater, the standard-of-review question will become even more important. This leads to difficulties. On the one hand, effective international cooperation depends on the willingness of sovereign states to constrain themselves by relinquishing at least minimum power to international tribunals to interpret treaties and articulate international obligations. Recognition of the necessity of this power does not diminish the importance of decision-making at the national level. On the other hand, nations and their citizens - particularly those interests within nation-states that are reasonably successful at influencing their national political actors - will want to maintain control of government decisions. Parties have invoked the principle of national sovereignty to justify deferential standard of review in the international context. Nation-states have also resisted relinquishing interpretive power to GATT/WTO panels on the grounds that to do so would compromise their sovereignty.[108]

Croley and Jackson are of the opinion that merely identifying important sovereignty values does not by itself provide a persuasive argument justifying deferential panel review. Taken alone, the argument that deferential review is necessary to protect authorities' national sovereignty fails to acknowledge that some balance between authorities' interest in protecting their sovereignty, on the one side, and the broader interest in realising the gains of international sovereignty, on the other, must be struck. They have suggested that a reasonable, nuanced approach by the WTO panels is important for the credibility of the WTO dispute settlement system. Such an approach will lessen the dangers of inappropriate unilateral reactions by governments and citizen constituencies of nation-state Members of the WTO. This approach is needed for virtually all types of cases and not just those

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106 Croley and Jackson (1996:199).

107 Croley and Jackson, op cit note 106 at 211-213.

108 Croley and Jackson, op cit 106 at 211.

in anti-dumping or other specified categories. What may be required is that panels (including Appellate panels) perceive and show sensitivity towards the issues involved when an international body reviews the legal appropriateness of national government authorities' actions.

Panels should thus keep the relevant purposes, strengths and limitations of their institution in mind. Because the international system and its dispute settlement procedures depend heavily on voluntary compliance by participating Members, Croley and Jackson[109] advise that the panels should be cautious about adopting "activist" postures in the GATT/WTO context. Inappropriate "panel activism" could alienate Members and threaten the stability of the GATT/WTO dispute settlement procedure itself. Panels should also recognise that voluntary compliance with panel reports is based on the perception that the panel decisions are fair, unbiased and rationally articulated. It is also important that Panels should recognise that national governments often have legitimate reasons for the decisions they take. Panels must also keep in mind that a broad-based, multilateral international institution must contend with a wide variety of legal, political and cultural values, which counsel in favour of caution toward interpreting treaty obligations in a way that may be appropriate to one society but offensive to other participants. Despite these and other reasons for judicial restraint, Panels must understand the central role that the GATT/WTO adjudicatory system plays in enhancing the implementation, effectiveness and credibility of the elaborate sets of rules the WTO was created to maintain. Successful cooperation among national authorities rests largely within the institution given the responsibility to help carry out the WTO's dispute settlement procedures. When a particular national authority's activity or decision would undermine the effectiveness of WTO rules, or would establish a practice that could trigger damaging activities by other Member countries, panels will be justified in showing it less deference.[110]

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109 Croley and Jackson, op cit note 106 at 212.

110 Croley and Jackson, op cit note 106 at 212-213.

5.5 The DSB and its implications for developing economies

The dispute settlement process has evolved enormously since 1947 when Articles XXII and XXIII provided the only real foundation for dispute settlement within the GATT. A very noticeable feature of the DSB is the movement away from the consensus-based system to the rule-based system which is now entrenched. The dispute settlement process is now more streamlined, with tighter deadlines, rules and procedures for consultations, panel and appellate body behaviour, more consistency and transparency in the dispute settlement process and less interference by affected parties in the adoption of panel reports. The rights and obligations of states under the DSB are also clearly stated. This has resulted in not only a more streamlined dispute settlement process but also a tighter, more legalistic approach to dispute settlement. With the more rule-oriented approach to dispute settlement have come complaints about the reduced sovereignty of states.

Upon accession to the WTO, all states have yielded some control over their ability to adopt trade regulations unilaterally to the WTO. They have therefore ceded some of their sovereign power to the WTO. The DSB is only a part of the WTO and an extension of its power to the area of regulation and administration. Upon accession to the WTO Members agree to be bound by all provisions of the WTO/GATT except for the plurilateral agreements. Cession of rights to the DSB is therefore one of the conditions of accession to the WTO. With the cession of these rights, however, the WTO has a corresponding obligation to Member states to ensure that they achieve their goals and are treated fairly and equally. The cornerstone of any dispute settlement body is that it should be impartial, transparent, just and fair. Within the DSB context, the dispute settlement process should be impartial and transparent. Except for Article 17.6 of the Agreement on Implementation of Article VI and concessions made to treatment of developing economies, all Member states are subject to the same rules and procedures which, once the dispute settlement process has begun, are almost automatic. Member states now have a right to a panel and they may join consultations as interested third states where they have a strong interest in the issue being discussed. There is therefore a greater openness and freedom amongst states. The composition of panels is also of significance to the process as an impartial tribunal is most likely to restore confidence among Member states. The DSB makes allowance for panels consisting of either three or five panellists, who are to be proposed by a

Secretariat. While the panellists may be from various countries, both developing and developed, in their capacity as panellists these individuals must serve in their individual capacities and not as government representatives or as representatives of any organisation. Panellists must also be well-versed in trade law and policy, being either independent academics or senior trade policy officials. Contributing to the impartiality of proceedings is the fact that representatives from disputing party states may not serve on a panel, unless the disputing parties so request. These factors, taken together with the fact that panellists are put forward by the Secretariat, allow for impartial panels.

While the actual dispute settlement process is transparent, the workings of the Secretariat are not. Nor are they open to questioning. Panel reports are available to all soon after completion of disputes, allowing interested parties to evaluate the reasoning of the panellists and determine their focus. Problems with transparency lie not with the actual work of the panels but the motivation of the Secretariat in choosing the particular panellists which it did. Of particular concern to Member states is the question of what comes first, the WTO trade agenda or their trade concerns. Although it may be claimed that there is little room for the Secretariat to manouevre given that the GATT provisions exist as guidelines, this is not altogether true. While the GATT provisions do exist and are binding on Member states, there exist many provisions which are open-ended and can be interpreted either liberally or conservatively. The choice of panellists offered by the Secretariat may therefore be calculated to achieve a particular liberal or conservative interpretation of a disputed requirement. This may therefore work for or against the ambitions of the disputing states.

The fact that there is no accepted doctrine of judicial precedent means that even though adopted panel reports are persuasive and to be consulted when dealing with similar or like issues, there is still room for panellists to interpret provisions differently and originally. While the lack of precedent may allow for progressive interpretation of principles as the mood within the global arena changes, Members do not have much certainty as to the meaning of provisions and are therefore unable to make accurate predictions. The issue of judicial precedent would appear to be a contentious one, however, as it would further entrench the rule-based approach to dispute settlement and could, therefore, be seen as a further attack on national sovereignty.

A way in which further transparency can be brought to the DSB is by the Secretariat announcing its procedure for choosing panellists. By making Member states aware of the procedure adopted, Members can be reassured of the openness and integrity of the Secretariat. While the need for transparency is important, a fact which works for the Secretariat is its independence. Given the contentiousness of some GATT issues and the interdependence of some Member states, it is important that the Secretariat is not influenced by the will of the more powerful states who may seek to place panellists sympathetic to their interests upon the relevant panels. While the Secretariat needs to be accountable to Member states and transparent in its dealings, it is important that it maintains its independence from Member states.

While the rule-based system may result in cries about the infringement of sovereignty, there can be no real argument against the fact that the rule-based system is of more benefit to Member states than the consensus-based system ever was. Not only has it brought about stability and order to the dispute settlement process, it has also inspired confidence among Member states, especially the developing countries, who are no longer at a disadvantage when it comes to setting up panels or entering into consultations. The rule-based system has, to a large extent, removed the ability of larger, more powerful states to intimidate their smaller more beleaguered trading partners. The confidence which the developing states have placed in the DSB is evident from their increased use of the dispute settlement process.

Despite the inroads made by the dispute settlement process, there is still room for improvement as the DSB has made some concessions to state sovereignty. Article 17(6) of the Agreement on Implementation of Article VI of the GATT 1994 places power in the hands of individual national states as the DSB has to respect the decisions of individual governments in anti-dumping disputes, where there is room for more than one permissible interpretation, if the evaluation was unbiased and objective. The existence of Article 17(6) indicates an unwillingness amongst some Member states, to abdicate totally responsibility for dispute settlement to the DSB. It also indicates that the DSB is not as invulnerable to attack as it might appear to be. While states have made a move towards a more stable dispute settlement process, Article 17(6) is a weak link in this system in that it indicates that Member states still have a way to go before they are prepared to relinquish power over their trading

processes to the WTO. This inability to relinquish power is problematic as it ultimately makes it difficult to level the playing field in any trade arena. For true independence and impartiality of the DSB to exist, Member states must allow themselves to be regulated by the DSB without attempting to control its outcomes.

On the issue of fairness, the concessions which the DSB makes to development and the needs of the developing economies will be analysed. More specifically, it will be examined whether provision has been made for differentiation and the effect of the differentiation on developing economies. The DSB has made provision for the special needs of developing economies where developing and developed economies enter into a dispute settlement session.[111] During consultations special attention must be given to the particular problems and interests of developing country Members. Panels must allocate sufficient time for developing country Members to prepare and present their arguments. Panel reports must also indicate the terms in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members.[112] Where a case is brought by a developing country Member the DSB, when considering what appropriate action to take, must take into account both the trade coverage of defaulting Members and their impact on the developing country Members concerned.[113] Article 24(1) provides that special consideration must be given to the needs of the least-developed economies at all stages of the dispute settlement process. Not only are Members to exercise restraint in raising matters against the least-developed economies, complaining economies must also exercise due restraint in seeking compensation or authorisation to suspend the application of concessions or other obligations relating to these procedures.[114]

It is evident that the DSB has made some concessions to development. Recognition has been given to the differences which exist between developed and developing economies with developing economies being given different treatment to other states, so there is some discrimination between

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111 See footnotes 51, 52 and 61.

112 See footnotes 91 and 92.

113 See footnote 97.

114 See footnote 102

developed and developing countries. Discrimination between developed and developing country interests is based on the recognition by Members that there is need for positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in growth in international trade in accordance with the needs of their economic development.[115] Special treatment of developing economies within the DSB context is an extension of this undertaking by Member states and seeks to ensure that concessions made to development are upheld during disputes between developed and developing economies. Discrimination between developed and developing Member states is therefore not *ad hoc*, but occurs within the context of a rational goal. There is therefore a rational connection between the discrimination and a legitimate GATT purpose.

Discrimination, in addition to be being rational, must be proportional, the means utilised being justified by the ends sought to the achieved. Basically the discrimination must not have an unduly negative impact upon those being discriminated against. Within the context of the DSB, developed economies may be impacted upon in three ways. Firstly, by giving developing economies slightly longer preparation time, the relevant developed economy will have to accept a slightly longer period for the resolution of the dispute. The time period will not be excessive, however. Secondly, when dealing with least-developed economies, developed states have to act with caution and place the needs of the least-developed economies first. Where the implementation of a provision negatively influences the growth and development prospects of a least-developed economy, the developed economy will have to act within the best interests of the LDC. Lastly, panellists must be mindful of the special and differential treatment extended to developing economies within the relevant Agreements and ensure that the developed economies are acting in accordance with these provisions, where applicable. While panellists may not act outside of the various provisions, they do, in some way, provide a means of monitoring the application of special and differential treatment.

In all three cases described above, the needs of developing countries, and especially LDCs, are placed before those of other states. While developed states may have to make sacrifices which may impact negatively on their positions or interests, they are not unduly affected. The impact of the discrimination cannot be deemed excessive as the discrimination does not place excessive burdens

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115 WTO, op cit note 1 at 6.

on the developed economies. The means employed are justified by the ends sought to be achieved. The discrimination is therefore proportional. The countries most likely to benefit from these concessions are the least-developed economies, however, as the DSB is obliged to go further than merely taking heed of concessions made to development within the various agreements.

While Member states are obliged to place the interests of the least-developed economies at least marginally above their own, there is no such additional duty placed upon Member states when interacting with non-LDC developing states. Member states are merely obliged to consider the special problems and developmental needs of developing economies during consultations and take into account concessions made to development in the various GATT Agreements. While panels must indicate how they have taken into account the concessions made to development within the various Agreements, panellists are not given the discretion to go further than these concessions where circumstances dictate the need to do so. Special and differential treatment is therefore limited to and restricted by the depth of concern and intention of Member states to make concessions to development during negotiations. The extent to which the developmental needs of normal developing economies are taken care of is therefore dependent upon concessions made during negotiations.

Given the difference in approach taken by the DSB to the interests of LDCs and other developing economies, the question of efficiency is raised. For the discrimination to be fair, it must also provide for efficient outcomes. Within the context of the DSB, the question of economic efficiency is not relevant. What is relevant, however, is whether the DSB is legally efficient. The question of legal efficiency is linked to the reduction and/or elimination of inequalities which exist between developed and developing economies. A question which will be asked is whether the DSB promotes redress amongst states. Because the DSB deals with disputes and not policy-making, panellists cannot be expected to, and are actually barred from, acting outside of the relevant GATT Agreements, except in the case of LDCs, when the Director-General may make an independent ruling. Where panellists may only work within the GATT framework, how can they ensure that Member states accept their obligations towards the development of developing states and promote redress?

The DSB places a positive obligation on Members and panellists to place the interests of LDCs first, at all stages of a dispute. In addition, the LDCs may seek the help of the Director-General for conciliation or mediation. While the attitude which the DSB has towards the interests of LDCs is likely to ensure that states make an effort to deal fairly with them, the LDCs still operate under a disadvantage. Where LDCs defend their interests or bring a complaint against either developed or developing economies, they are likely to come up against better prepared legal counsel as the more developed states will have access to better, more expensive and experienced legal counsel. Regardless of the merits of the case, where legal counsel are inexperienced or unskilled, they are unlikely to achieve the best outcome possible within the circumstances. Even where the odds are in their favour, the LDCs may not be able to achieve outcomes which really support their developmental goals because poor counsel. This is a handicap for LDCs and other developing economies and one which the DSB does not address. While the DSB emphasises the need for developed economies to act in accordance with their positive obligation to assist least-developed economies reach their developmental goals, and provides an environment in which the interests of LDCs are placed prior to the interests of other states, this is merely an extension of the special and differential treatment given to LDCs in the various Agreements. Problems experienced by LDCs in bringing complaints before panels are not dealt with. Despite the problem which developing economies experience with regard to lack of funding and lack of access to experienced counsel, the obligation which states have to cater for LDC country needs may help alleviate this disadvantage. Non-LDC developing economies remain at a disadvantage, however, as states are not obliged to provide them with advantages which extend beyond the special and differential treatment referred to in the relevant agreements.

Redress requires positive action which addresses the inequalities between states and puts forward solutions which address these inequalities. By placing the needs of LDCs before those of other states, the DSB gives the LDCs a greater chance of achieving outcomes which further their developmental goals and prevent them from compromising their position. This provision does address inequalities amongst the LDCs and other states. While the provisions which favour LDCs are a positive step, they do not go far enough.

While the advanced developing and upper middle-income developing economies may be able to defend their interests effectively, the middle-income to low-income developing economies may not be as able. The LDCs are not therefore the only developing economies in need of special treatment. Inequalities exist between all developing and developed economies. By limiting special measures to LDCs alone, the DSB effectively ignores the needs of other developing economies, some of which are almost as disadvantaged as the LDCs. Within the context of the DSB, neither LDCs nor normal developing economy interests have been properly dealt with, with inequalities between these states and developed economies remaining intact. Apart from the treatment of LDCs, no real positive obligations have been placed on Member states to adopt measures which will enable developing economies to interact with developed Members on a more equal footing. The discrimination does not, therefore, lead to legally-efficient outcomes.

A fact that is evident from the above discussion is that, apart from the obligation that all states have to act with caution when dealing with LDC interests, no real measures have been adopted which attempt to address the power imbalance amongst states. The actual DSB process is itself impartial. This is a development which has garnered the trust of the developing economies. Consultations still occur between states prior to panel proceedings. Where consultations occur between developed and developing countries, the power imbalances which normally exist amongst these states are carried over. With multiple complaints, the offending state has the power to decide whether to deal with groups of states singly or as a unit. While the provision itself is not wrong, the implications of such choice in the context of power can be great. An example would be where Lesotho was to complain about the trade practices of the USA. Where the USA chooses to deal with Lesotho alone, instead of the Southern African Development Community (SADC) countries together, where they are all affected, the outcome would probably be different. The same occurs for levels of representation of countries, as differences between the status of states would again be apparent. The interests of normal developing economies are, apart from special and different treatment extended to these states in the various Agreements, to be treated in the same manner as developed states. While the provision itself seeks not to limit the sovereignty of states, it does leave room for undue power play amongst states. This is a possibility which cannot be allowed. While formal equality amongst states permits panels to be impartial, where states or groups of states have unequal power, recognition should be given to

these differences. Such recognition has only been given to LDCs and not non-LDC developing states who are also disadvantaged. Without provisions which allow for the correction of this position and permit states to solve their disputes on a more equal footing, the DSB cannot be deemed fair as it has not gone for enough to solve the difficulties experienced by the non-LDC developing states.

5.6 WTO negotiations

The shortcomings of the DSB cannot be taken into isolation, however, as they reflect the decisions made by Member states during negotiations. Negotiations can be divided into the actual negotiation of new rounds of Agreements and the work done by the various formal groups and informal small group meetings. Much of the work done before the main rounds occurs in informal meetings by small groups. "Formerly", all the councils and committees consist of the full membership of the WTO. These groups are not the same, however. In practice, the people participating in the various councils and committees are different because different levels of seniority and different areas of expertise are needed. Heads of missions, usually ambassadors, normally represent their countries at the General Council level. Because some of the committees can be highly specialised, governments sometimes send expert officials from their capital cities to participate in these meetings. At the level of the Goods, Services and TRIPS Councils, delegations assign different officials to cover the different meetings.[116]

Important breakthroughs are rarely made in any of these formal bodies, especially not in the higher level councils. With consensus and without voting, informal consultations within and outside of the WTO play a vital role in bringing the extremely diverse membership round to an agreement. A step away from the formal meetings are the informal meetings which still include the full membership. More difficult issues are dealt with in the smaller groups, which involve as many as 40 countries most interested in a particular issue under discussion. Deadlocks can occasionally only be broken in a small group of two, three or four countries, sometimes at meetings they have organised themselves

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116 WTO (1998:63).

in their own countries. Commitments made by Members during multilateral negotiations are often the result of numerous bilateral, informal bargaining sessions.[117] This occurs because drafting groups where all Members are represented are unrealistic and restricted participation is in many cases the only effective way to proceed. Agreement in smaller groups is then extended to other less directly concerned countries. Absence from meetings is as common for industrial countries as it is for developing countries. Absence may also be attributed to the fact that groups of countries may meet privately of their own volition to discuss common interests, and choose whom they wish to have present.[118] When these groups meet, however, representation of interests is critical. In informal consultations, there is, in principle, always representation from all the different parties with an interest in the matter under discussion. Without broad representation, consensus could at a later stage be blocked by those annoyed at not being part of the informal process or not seeing their interests reflected.[119]

Despite the safeguards and the reasoning behind the negotiating process, WTO Members do not have the same power in the process. Because information is power, the more informed countries are better placed to negotiate. The more economically powerful countries are also given a greater hearing in almost all areas of negotiation. This is largely due to the nature of the negotiating process in the WTO. Agreement is by consensus, which is frequently achieved by trade-offs across different areas of commercial interest. The powerful countries have more to offer in terms of trade-offs and are therefore in a better position to leverage less powerful countries into agreeing on the preferred consensus decision.[120] Even with the existence of safeguards, developing countries are systematically absent from both formal and informal meetings. This non-participation is due, however, to a lack of resources and expertise to service the negotiating process. Most small delegations do not have the appropriate resources either in Geneva or in their capitals to service the negotiating process. Some small nations do not even have representation in Geneva. These factors make any meaningful

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117 WTO, op cit note 116 at 163.

118 Sampson (1995:1100).

119 Sampson, op cit note 118 at 1100.

120 Sampson, op cite note 118 at 1107.

participation of developing economies in the negotiating process a near impossible dream.[121] Article 2(iii) of the Decision on Measures in Favour of Least-Developed Countries[122] provides that sympathetic consideration be given to specific and motivated concerns raised by the least-developed countries in the appropriate councils and committees. Without sufficient representation of least-developed countries who are most likely not as informed as the developed economies about the possible effects of provisions on their economies, it is highly unlikely that the concerns and interests of the least-developed economies are being properly dealt with in negotiations. The Ministerial Declaration on the Uruguay Round, Part 1 (B) (vii) had as one of its governing principles the fact that special attention was to be given to the particular situation and problems of the least-developed countries.[123] Regardless of the intention of the Member states, without input from the least-developed economies, it is highly unlikely that their interests would have been given the proper care which they deserved.

Because the negotiating process provides the foundation for future agreements, imbalances in the process can and do filter through to the actual Agreements. It is safe to assume that daily negotiations deal mostly with developed country interests, because these countries can offer ambassadors, expert witnesses and participants to various council meetings and have the negotiating power to ensure that their interests are considered. The issue of developing country representation is a crucial one, however. The lack of monetary resources experienced by the developing countries is well-known. So is the fact that many government representatives to Geneva are not sufficiently expert or equipped to deal with the complex matters being discussed in the formal and informal councils and committees.

Member states have committed themselves to increased global welfare and the growth and development of the developing economies. Without representation of developing country representatives at a WTO Council level, without the proper information, developed Member states

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121 Sampson, op cite note 118 at 1100.

122 WTO, op cit note 1 at 441.

123 Jackson, op cit note 6 at 183.

cannot really say that they have actually carried out their obligations. There is also the issue of fairness. The WTO states as one of its objectives the increased growth and development of developing economies. Equality of all Member states in another principle of the WTO. As such, all Members must be given an equal chance to be heard. Apart from the Declaration which requires Member states to consider the needs of developing economies during negotiations, all states are treated equally. There is therefore no differentiation between developing and developed economies at the stage of negotiations, even though it is at this stage that differentiation between developing and developed economies would make a difference to the outcome of negotiations. Because negotiations are based upon market power and the ability to make concessions, countries with greater market power have greater leverage with which to influence the outcomes of GATT. The developing economies, who are mostly without market power do not therefore have much negotiating strength, unless they act together. Where negotiations occur within small groups, it is most likely that the more prominent, wealthier developing economies will enter into negotiations with wealthy developed states with greater leverage than developing economies. Even where the interests of developing economies are being negotiated, they are achieved at a cost to developing economies. The advantage of greater leverage extends to the question of agenda setting for various new WTO rounds of negotiations. Topics to be discussed are determined through trade-offs or bargaining amongst states. While the WTO is officially a multilateral forum for discussion, the fact that most important negotiations occur bilaterally or in small groups undermines the ability of the developing states to ensure that their interests are truly represented. As a result, those states with the greatest economic power have the greatest leverage and are therefore able to influence the outcome of negotiations at all levels. In a forum which embraces equality amongst states, this cannot be condoned and is unfair as it entrenches power play amongst states. While it may be argued that a certain amount of power play amongst states is to be permitted, at what point is redress then permissible? The WTO negotiating process is at present based upon a formal definition of equality. As a result, negotiations are process rather than outcomes based. Inequalities amongst states are therefore entrenched by the system and built into the negotiating process. While provisions exist which urge states to consider the needs of the developing states, these states are themselves prevented from contributing meaningfully in any trade discussions or influencing future trade agenda or present negotiations because they lack the economic leverage to do so. For the negotiating process to be considered even

marginally fair, all states would have an equal chance of influencing the outcomes of negotiations or determining the agenda of future negotiations. States should therefore be permitted to exercise sufficient power to achieve their economic goals without denying other states from pursuing their own goals. A system which permits states to dominate negotiations and prevent or hinder other states or groups from pursuing their own objectives is therefore not fair as such power play is excessive. The present system, through bargaining and trade-offs, permits some states to dominate discussions and therefore influence the outcome of negations. Through power play, states with greater leverage are able to infringe on the ability of other, less powerful states to negotiate efficient outcomes. All states are therefore not equal. Formal equality cannot therefore be seen as sufficient or adequate as it does not permit redress or address existing inequalities amongst states. Rather it supports the abuse of power.

Where developing economies are unable to represent themselves at Council meetings or at WTO headquarters, other Member states who are present may act on their behalf. This is not an optimal situation given that developed Member states are unlikely to represent the needs of the developing and LDC states correctly. An issue which should be raised in this context is the inability of some developing countries to represent themselves correctly on some GATT issues given that the issues being discussed are, at that stage, of no significance to their economies. Despite the very real differences between developed and developing economies which influence the outcomes of GATT or GATS negotiations, no effort has been made to address these differences and provide the developing economies with a greater chance of achieving provisions which are both economically efficient and development friendly.[124] At this stage of negotiations there is no recognition of differences amongst states, despite the very real differences which influence the outcome of negotiations. At a stage where recognition of differences would impact directly on the achievement of outcomes which satisfy both groups of states, this oversight is neither rational nor proportional. A system which permits the less powerful to negotiate on the same terms as more powerful economic powerhouses cannot be deemed efficient, neither economically nor legally. The fact that negotiations

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124 Mbekeani (2002:10). Reference is made in this article to the fact that meetings in which contentious issues are being negotiated are limited to major developed countries and a small number of invited developing countries. This is a practice which effectively limits the power of developing states to effectively influence negotiating outcomes.

are dependent on the ability of a state to make concessions or trade-offs, means that the most powerful economies are able to influence the outcomes of GATT negotiations and secure provisions which are more likely to support their economic needs. Because the developing economies do not have the resources to represent themselves, in the interests of fairness, the remaining Member states should contribute, in some way, so as to enable the developing country Members to put forward their cases and concerns. The system, as it stands, is inadequate and unfair as it does not even seem to recognise the implications of non-representation and lack of proper expertise on the ability of developing countries to contribute meaningfully towards WTO Council and Committee meetings.

Given that equality within the WTO should extend to all areas which influence the ability of developing economies to increase the welfare of their people, the fact that within the negotiating arena developed and developing countries are treated equally is discriminatory. At the level where developing economies have the most to contribute, their lack of resources are used against them. If the developed countries really were interested in hearing from the developing economies, provisions would be made which give the developing economies a proper hearing. It is quite clear that the negotiating process favours those countries with sufficient resources to ensure representation at a WTO level. It is this very fact which makes the WTO negotiating process unfairly discriminatory.

5.7 Conclusion

The WTO has come a long way since Article XXII and XXIII. As a dispute settlement body it attempts to be impartial, transparent and consistent. On the topic of special and differential treatment, the least-developed economies fare much better than normal developing economies in that their rights are not really represented and any intervention on their behalf is limited to concessions made to development in the individual agreements. The DSB, despite provisions which favour developing economies, does not sufficiently provide for developing country needs or address existing inequalities between developed and developing states. Lack of differentiation can be further traced to the negotiating process which does not allow for differential treatment between the poor and richer nations at a stage when it is this very difference which has the greatest impact on the ability of

developing economies to put forward their position and be heard. In many cases, even if the developing economies were sufficiently represented, they would not have access to the type of expertise necessary for their representatives to decipher the effects of the various agreements on their economies. At the very least, there should be a right to representation of all parties at the various working groups, with concessions being made to developing economies with respect to costs. Until provisions for differentiation are made at a negotiating level, the negotiating process cannot be deemed equal and fair in any way, as it does not enable the developing economies to properly represent themselves. An even more pertinent issue is that of balancing power at a negotiating level. Without safeguard provisions which ensure that the needs of all developing economies and not merely the least-developed economies are given precedence, the negotiation of trade provisions will always favour the needs and requirements of those countries with the greatest bargaining power. Until this bias is removed, the developing economies will never really be represented in any WTO negotiations and will always have to play second-fiddle to the requirements and desires of the developed countries.

Chapter 6

The Agreement on Agriculture

6.1 Introduction

The issue of agricultural liberalisation and the corresponding reduction and elimination of agricultural subsidies and governmental assistance have been and remain thorny ones for both developing and developed countries, as they are closely linked to food security and political stability. Both developed and developing country governments have been wary about exposing their farmers and agricultural sectors to the vagaries of a free market and global competition.[1] While there is much talk about levelling the agricultural playing field, there is some doubt about whether developing and developed countries are playing on the same field at all as the issues facing these countries' agricultural sectors are very different. The Uruguay Round began with negotiating parties being divided into two major camps.[2] Some parties felt that there should be significant reform of the trade rules in agricultural trade which should take place through reductions in border protection and removal of other trade-distorting policies. Others were of the opinion, however, that agriculture is a special case and that all countries should not be required to adopt the same policies for internal protection regardless of farm structure and the degree of self-sufficiency.[3]

Reasons for the continued support of agricultural protection will be considered before the Agreement on Agriculture is discussed. Developing countries have put forward two different sets of arguments against the Agreement. The first is based upon the actual shortcomings of the Agreement while the

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1 Martin and Winters (1995:1-3).

2 This was not necessarily a North-South division. A party's negotiating position was based rather on the number of domestic or export subsidies which it extended to its farmers. Those with few or no domestic or export subsidies sought to end subsidies in both their prospective foreign markets and by competing exporters (Martin and Winters, op cit note 1 at 3).

3 Martin and Winters, op cit note 1 at 2-3.

second is based upon the issue of food security. Both these arguments will be discussed in this chapter. The question raised is whether the Agreement on Agriculture discriminates against developing economies.

6.2 Rationales for agricultural protection

While countries have actively sought the liberalisation of global commodity and now service industries on the grounds of comparative advantage and free trade, there has been vast support for the protection of agriculture. While this can be attributed, in part, to the influence of powerful farm lobbies in North America, Europe and Japan, there are a number of long-standing arguments put forward for the protection of agriculture. The main arguments relate to self-sufficiency or national security, exceptional price instability and the preservation of the rural way of life and/or the environment.[4]

6.2.1 Self-sufficiency or national security

Without access to food, a nation cannot survive. At various times during human history, nations have been threatened by famine. For many developing countries, lack of access to domestically supplied agricultural products remains a sad reality, whether caused by war, pestilence or drought. In times of shortage, access to food from foreign sources may be limited as countries usually impose export restrictions to ensure that their own residents are fed first. In these circumstances, self-sufficiency is deemed to be an acceptable reason for agricultural protection. For these countries the goal of self-sufficiency justifies the use of measures that maintain agricultural production in circumstances in which it would be more efficient for most or all of a country's food needs to be met by imports. Governments also seek self-sufficiency on the grounds that not having to rely on foreign countries which may be enemies or potential enemies in times of war puts them at an advantage.[5]

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4 Trebilcock and Howse (1999:252-254).

5 Trebilcock and Howse, op cit note 4 at 252-53.

6.2.2 Price instability

Price fluctuations in the agricultural sector are often considerably greater than those of other traded commodities, largely because supply is susceptible to unpredictable factors such as weather. As a result, farm incomes are highly volatile. The costs faced by farmers,[6] on the other hand, are to a large extent likely to be fixed. It has therefore been argued that unless supply is restricted, or prices stabilised by other means, a bad year could result in farmers being put out of business completely even though they nevertheless have an ongoing comparative advantage in producing food. While this argument may prove to be without substance in developed economies where farming is dominated by large commercial producers, the same cannot be said of many developing countries where the small farmer dominates.[7]

6.2.3 Preservation of the rural way of life or environment

The efficiency of agricultural production has increased enormously in most developed countries, especially over the last few decades. Even if a certain level of domestic food production could be seen as necessary for self-sufficiency reasons, or price stabilisation could be justified as a means of making farm incomes less volatile, there would nevertheless still be a long-term shift of both land and people away from agricultural production. Existing demand can be met with less land and fewer farmers. In recent years the argument for agricultural protection has been that keeping land and people in farming is a social good in itself. Regarding land, the reasoning has been that, but for agricultural usages, the countryside would be much more heavily burdened with ugly, polluting industries, or simply replaced by industrial or commercial towns. A closely related argument states that agriculture sustains rural communities, which would either disappear or lose their distinctive character if economic activity in the countryside was shifted away from agricultural production. In

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6 Repayment of loans, equipment, seed, fertilizers, labour etc.

7 Trebilcock and Howse, op cit note 4 at 253.

developed economies in Europe, for example, the countryside is viewed as a natural and cultural treasure that would be fundamentally threatened if land were taken out of agricultural production.[8]

While this argument may hold true for developed economies the same cannot be said for developing countries. In these countries a large percentage of the population is still actively involved in agriculture. Unlike the large agricultural co-operatives which are prevalent in developed countries, agriculture in developing countries consists largely of small scale farmers. While a small percentage of produce finds its way to the market, the rest is used by farmers for sustenance or for barter. With the promotion of industrialisation or mechanisation by governments, there is increasing pressure on land from non-agricultural users, because of both the rising level of urbanisation as well as the geographic spread of industries.[9] While agricultural producers remain a powerful political force in most industrial countries, in many developing countries the political power of urban consumers and civil servants often outweighs the power of farm producers, even where the majority of the population is dependent on farming.[10]As a result of urban bias in developing countries, there is very little sympathy or sentimentality for the place of agriculture within the psyche of developing country dwellers.

6.3 The Agreement on Agriculture

While the Agreement on Agriculture emerging from the Uruguay Round does not cover all of the most important issues facing agriculture, a great deal of progress has been made in those areas it does cover. Through the process of tariffication, one hundred percent of all agricultural products in developed and developing countries alike will be covered by bindings and all quantitative restrictions must be eliminated and/or converted to tariffs. While, in practice, tariffication will not necessarily greatly reduce protection of agriculture, the fact that Members agreed to such changes is a positive

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8 Trebilcock and Howse, op cit note 4 at 253-54.

9 Raghavan (1999:20).

10 Martin and Winters, op cit note 1 at 2.

development.[11] The main features of the Agreement on Agriculture are reduction in domestic support, reduction in export subsidies, tariffication and tariff reductions. A brief discussion of each follows.[12]

6.3.1 Reduction in domestic support

Developed Member states of the World Trade Organisation (WTO) agreed to reduce domestic support programmes by 20 percent over a six-year period, equivalent to $35 billion, of which $15 billion is in the EU, $7 billion in Japan and $4.7 billion in the USA, with 1986-8 as the base period.[13] In other words, at the end of the six years from the entry into force of the Agreement on Agriculture in 1994, domestic support must be 20 percent lower than it was in the 1986-8 period.[14] The domestic support commitments by Members must apply to all their domestic support measures in favour of agricultural producers. An exception is the use of domestic measures which are not subject to reduction according to the criteria set out in Article 5 and Annex 2 of the Agreement on Agriculture. Annex 2 provides that those domestic support measures which meet the fundamental requirement that they are not trade distorting or have at most minimal trade distorting effects on production be exempted from the reduction commitments.[15] Of these, the most controversial are the "Green Box" provisions which exempt from reduction subsidisation through direct payment to producers. Exemptions include decoupled income support, government financial participation in income insurance and income safety-net programmes, payments made either directly or by way of government financial participation in crop insurance schemes for relief from natural disasters, structural adjustment assistance provided through producer retirement programmes, structural adjustment assistance provided through investment aids, payments under environmental programmes and payments under regional assistance

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11 Harrold (1995:14).

12 For in depth commentary on these points, see Tangermann (1997:7-40).

13 Harrold, op cit note 11.

14 Trebilcock and Howse, op cit note 4 at 262.

15 Article 1, WTO (1994:56).

programmes.[16]

Domestic support is to be measured according to the Aggregate Measure of Support (AMS).[17]As a means of encouraging agricultural and rural development in developing countries, investment subsidies which are generally available to the agriculture sectors of developing country Members and agriculture input subsidies generally available to low-income or resource-poor producers in developing country Members are exempt from domestic support reduction commitments that are otherwise applicable to such measures.[18] Members are not required to include product-specific domestic support in the calculation of their current total AMS and are not required to reduce non-exempt product-specific domestic support where such support does not exceed five percent of that Member's total value of production of a base agricultural product during the relevant year. The same applies for non-product-specific domestic support. Developing country Members are allowed a *de minimis* percentage exemption of 10 percent before non-product specific domestic support has to be included in the calculation of their current AMS.[19]

Any domestic support measure in favour of agricultural producers or modification to such measure or any measure that is subsequently introduced that does not satisfy the criteria of Annex 2 or is not exempt from reduction by reason of any other provision of this Agreement must be included in the Member's calculation of its current total AMS. Where no total AMS commitment exists in Part IV of a Member's schedule, the Member may not provide support to agricultural producers in excess of the relevant *de minimis* levels of 10 percent.[20]

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16 Articles 5-13, Annex 2.1, WTO, op cit note 15 at 58-62.

17 Article 1, WTO, op cit note 15 at 40. The AMS refers to the annual level of support, expressed in monetary terms, provided for an agricultural product in favour of the producers of the basic agricultural product or non-product-specific support provided in favour of agricultural producers in general, excluding support provided under programmes which are exempt from reduction under Annex 2 of the Agreement.

18 Article 6(2), WTO, op cit note 15 at 46.

19 Article 6(4)(a and b), WTO, op cit note 15 at 46-47. *De minimis* means of "minimum impact" and can be traced to the phase "*de minimis non curate lex*" which means that the law is not concerned with trifle (*www.tnrcc.state.tx.us/excc/small.business/deminimis.html)* 20 July 2002.

20 Article 7(2)(a &b), WTO, op cit note 15 at 47.

6.3.2 Reductions in export subsidies

Developed countries have agreed to reduce export subsidies by 36 percent from their average 1986-90 levels, which is equivalent to $7.5 billion. $4.5 billion of the reductions will occur in the EU.[21] Reductions are to occur over a six-year period with a 21 percent reduction in terms of the volume of agricultural products that receive such subsidies and 36 percent in terms of total cash value. For developing country Members these percentages are a 14 percent reduction in terms of the volume of agricultural products that receive such subsidies and 24 percent of total cash value.[22] Except for certain permitted minor adjustments,[23] Members have undertaken not to expand export subsidies beyond the levels reached after the achievement of their six-year reduction commitments.[24] In the second to fifth years of the implementation period, Members may provide export subsidies listed in Article 9(1) in a given year in excess of the corresponding annual commitment levels in respect of the products or groups of products specified in Part IV of the Member's Schedule. The cumulative amounts of budgetary outlays for such subsidies must not exceed the cumulative amounts that would have resulted from full compliance with the relevant annual outlay commitment levels specified in a Member's Schedule by more than 3 percent of the base period level of such budgetary outlays. In addition, the cumulative quantities exported with the benefit of such export subsidies must not exceed the cumulative quantities that would have resulted from full compliance with the relevant annual quantity commitment levels specified in the Member's Schedule by more than 1.75 percent of the base period quantities.[25] During the implementation period, developing country Members are not required to undertake commitments regarding export subsidies listed in subparagraphs (d) and (e) of paragraph

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21 Harrold, op cit note 11. Article 9 (2)(b)(iv), WTO, op cit note 15 at 49.

22 Harrold, op cit note 21.

23 Article 9(2), WTO, op cit note 15 at 49.

24 WTO, op cit note 23.

25 Article 9 (2)(b) (i-iii),WTO, op cit note 23. The total cumulative amounts of budgetary outlays for such export subsidies and the quantities benefiting from these export subsidies over the entire implementation period must be no greater than the totals that would have resulted from full compliance with the relevant annual commitment levels specified in the Member's Schedule. Cumulative amounts are calculated from the beginning of the implementation period through to the year in question.

1, provided these subsidies are not applied in a manner that would circumvent reduction commitments.[26]

Analysis of the implementation of the Agreement on Agriculture by the Organisation for Economic Cooperation and Development (OECD) countries has shown that while trade- distorting domestic support measures accounted for 76 percent of the AMS share in the 1986-88 base period, this figure had fallen to 54 percent of the AMS share in 1996. The decreasing use of trade-distorting domestic support measures has been attributed to the increased use of "Green Box" measures which have been deemed non trade-distorting by WTO Members. Four OECD members, Iceland, the USA, the EU and Norway initially provided Blue Box supports, which include exempt direct payments provided under production-limiting programmes. Since 1995 the USA and Iceland have not notified these payments. During the 1995-98 period, these payments amounted to 23 percent and 33 percent of all notified support outlays for the EU and Norway, respectively.[27] In the case of the OECD countries, the AMS commitments over the implementation period (1995-2000) were already fully met by 1995 or were expected to be met following only minor policy adjustments. Despite reduced AMS levels, total support for agriculture has not declined. Analysis by the Food and Agricultural Organisation (FAO) has shown that not all policies exempt from reduction commitments are indeed production and trade neutral, as was assumed. Evidence has shown that in the case of the OECD countries, total support of agriculture as measured by the Producer Support Estimate has not declined in recent years.[28]

Very little information is available on the implementation experience of the developing economies. A study of 14 developing economies by the FAO Secretariat has shown, however, that only one of the 14 sample countries reserved the right to subsidise agricultural exports. The right of export subsidisation was not an issue, probably because 9 of the 14 countries were net food-importing

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26 These relate to the provision of subsidies to reduce the costs of marketing exports of agricultural products other than widely available export promotion and advisory services and internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments, respectively (Article 9(4), op cit note 23).

27 FAO (2001:2).

28 FAO, op cit note 27 at 3.

countries.[29]

6.3.3 Elimination of non-tariff border measures

Members cannot maintain, resort to, or revert to any measures of the kind that have been required to be converted into ordinary custom duties, except as otherwise provided for in Article 5 and Annex 5.[30] These measures include quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary custom duties, whether or not the measures are maintained under country-specific derogations from the provisions of GATT 1947, but not measures maintained under balance-of-payments provisions or under other general, non-agriculture specific provisions of GATT 1994 or the other Multilateral Trade Agreements in Annex 1A to the WTO Agreement.[31] For products subject to tariffication, current access opportunities, in quantitative and other terms, must be maintained on terms at least equivalent to those existing prior to the tariffication process. In the case of those products for which little or no imports took place due to the protectionist nature of the pre-existing regime, minimum market access opportunity commitments are required. Existing non-tariff border measures must be reduced to allow foreign producers a minimum of three percent market access to domestic markets in the base period 1986-88, rising to five percent of that base figure by the end of the implementation period in 2000 in developed countries or 2004 for developing countries.[32] Members have recourse to the special safeguard provisions of Article 5(4) and (5) in connection with the importation of an agricultural product, in respect of which measures referred to in paragraph 2 of Article 4 of the Agreement on Agriculture have been converted into an ordinary customs duty. These special safeguard measures may be involved if the volume of imports of that product entering the customs territory of the Member granting the concession during any year exceeds a trigger level which relates to the existing market

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29 FAO, op cit note 27 at 4.

30 Article 4(2), WTO, op cit note 15 at 42.

31 Article 4(2), WTO, op cit note 30.

32 WTO (1995:21).

access opportunity as set out in Article 5(4). They may also be invoked if the price at which imports of that product may enter the customs territory of the Member granting the concession falls below a trigger price equal to the average 1986-1988 reference price for the product concerned. These conditions cannot be applied concurrently.[33]

6.3.4 Tariff reductions

The new tariffs which have resulted from the conversion of non-tariff border measures together with the tariffs not affected by tariffication must be reduced by an average of 36 percent by developed countries and 24 percent by developing economies (other than the least-developed). Minimum cuts on each tariff line of 15 and 10 percent, respectively, are required. No reduction is required in the case of least-developed countries. The majority of tariff lines that were not bound at 70 percent going into the Uruguay Round were reduced and bound by the developed countries and the transition economies. Developing countries, especially in Latin America and Africa, have agreed to bind at ceiling levels, but not reduce, a number of their agricultural tariffs.[34]

Unlike tariff reductions, which actually reduce protection levels, tariff bindings merely signal an intention to change because they have no effect on actually applied tariff rates. While tariff bindings are meant to prevent arbitrary, erratic tariff increases, the fact that price ceilings are set at extremely high levels, for example, 300 percent on a product with an applied tariff rate of 38 percent, can eliminate the usefulness of tariff bindings. Despite tariffication, actual protection rates in agriculture within OECD countries are still high and have not declined in recent years. An OECD study has shown that the overall level of tariff protection for agricultural products, measured with production-weighted averages of applied MFN tariffs, was higher in 1996 than in 1993 for eight of the ten OECD Member states and groupings covered, with the EU being one. Protection rates were particularly high in the food processing sectors. In addition, the structure of tariffs remains complex in many cases,

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33 Article 5(1)(a) & (b), WTO, op cit note 15 at 43.

34 WTO, op cit note 15 at 18.

limiting transparency.[35] The FAO study of 14 developing economies has shown that applied tariff rates were much lower than the WTO bound rates. There were, however, several cases where countries applied higher rates or surcharges, indicating specific difficulties for their domestic producing sectors during low world price periods, particularly for basic food products. Tariffs were often the primary, if not the only trade instrument available to these countries for stabilising domestic markets in the face of external shocks.[36]

6.4 Developing country concerns

Developing country concerns about the Agreement on Agriculture can be divided into two distinct subgroups. The first relates to declining food aid and issues of food security while the second is based on actual concerns which these countries have with the provisions of the Agreement on Agriculture. These will be discussed in detail below.

6.4.1 Food aid, security and subsidisation

The volume of food aid declined by 50 percent between 1987 and 1997 with food aid shipments declining from 12.7 million tonnes in 1987 to 5.43 million tonnes in 1997.[37] No reasons have been provided for the decrease in food aid, although the UN Food and Agriculture Organisation stated that except for rice, food prices were lower, and this was a contributing factor.[38] The decline in food aid and food aid shipments have been of grave concern to the least-developed countries and the net-food-importing developing countries. They have not accepted the view held by the US or the Cairns Group[39]

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35 FAO, op cit note 27 at 3.

36 FAO, op cit note 27 at 4.

37 Raghavan, op cit note 9 at 20.

38 Raghaven, op cit note 9 at 18.

39 The Cairns group is an informal association of agricultural exporter countries accounting for one-third of world farm exports which seeks to reduce export subsidies and internal support measures, and to bring about other reforms to international agricultural trade. Members include Argentina, Australia, Brazil, Canada, Chile, Columbia, Malaysia, South Africa, Thailand and Fiji (Raghavan, op cit note 9 at 20).

that freeing the markets will facilitate imports, thus providing food security. It is the view of these countries that if a country does not have the foreign exchange or resources to buy and import food, or if rural people have no employment or earnings to pay for food and basic needs, there is neither security nor any prospect of ending poverty, hunger and under-development.[40]

In India, for example, ensuring food security is a basic objective of government policies in agrarian developing countries.[41] Food security is defined as access of a population to sufficient food to meet nutritional requirements. As a result food security issues cover not only issues related to availability and stability of food supplies but also to issues of access to its food supply. Sufficient supply is related to the resources needed to procure the required quantity of food. As issues related to food security are sensitive, countries where a large percentage of the population is dependent on agriculture need a certain degree of autonomy and flexibility in determining their domestic agricultural policies. The latter would have to be geared towards improving productivity, enhancing income levels, and reducing vulnerability to market fluctuations by ensuring price stability. In this sense food security is a legitimate national concern and has been so recognised by the FAO. This recognition of food security underlines a developmental perspective which goes beyond mere trade concerns, and is therefore relevant to the outlook and interest of developing countries.[42]

On the issue of foreign exchange reserves the Indian position is that those countries supporting rapid liberalisation of the agricultural sector have argued that global food sufficiency would ensure food security since countries could then produce what they were most competent and efficient at while importing the rest of their food requirements. This argument rests on the assumption that all countries would at all times have sufficient foreign exchange to procure their food requirements internationally. This assumption is not correct, however, as not all developing countries are in a position to import food grains, even if these were available at competitive prices, because of limited foreign exchange reserves. These countries also face cross-sectoral pressures on their available funds, further limiting

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40 Raghavan, op cit note 9 at 18.

41 Raghavan, op cit note 9 at 19. For more on the problems pertaining to food insecure countries and potential solutions, see Stevens (2002:8-21).

42 Raghavan, op cit note 9 at 19-20.

the capacity to procure food internationally. This problem is further compounded in cases where there are unforeseen variations in international prices.

Internal constraints can also severely limit the capacity of developing countries to increase their domestic production to at least a minimum percentage of their requirements. The first constraint is linked to the small size of holdings in developing countries and the fact that the majority of farmers belong to the small and marginal category. The small size of holdings limits attempts to introduce mechanised farming and makes it difficult to adopt new techniques without the adoption of large scale extension programmes as well. Productivity is therefore low, with total production varying substantially, as a large percentage of the agricultural sector is at the mercy of the vagaries of nature. If this limitation on the availability of agricultural land is viewed in the context of increasing population growth, which most developing countries face, it is clear that the only way agricultural grants can be sustained and the food security objective attained would be through increased government support in the use of inputs, particularly irrigation, electricity, fertilizers, pesticides, technical know how, high yielding varieties, infrastructural development and market support. As the agricultural sectors in developing countries comprise mainly small farmers, it has to be recognised that a major part of the financial burden of increased inputs will have to be met by government subsidies, as small farmers will not be able to meet their principal responsibilities without sufficient support from government.[43]

Developing countries have based their argument for the need to produce their own staple food on three grounds. First, as noted earlier, with very few exceptions, developing countries suffer from a chronic shortage of foreign exchange. Depending on imports for their staple food in such a situation may cause difficulties and uncertainties about the availability of food in these countries. With the privatisation of agricultural trade, dependence on food imports may also cause serious uncertainties and frequent high increases in the prices of staple food products. A delay in the import of food at the time of a foreign exchange shortage could result in extreme food-rationing and possible social unrest.[44] Second,

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43 Raghavan, op cit note 9 at 20.

44 Lal Das (1999:21).

even if adequate foreign exchange is available, imports may not be readily available at times of need for various reasons. Lastly, dependence on imports for a country's staple food may reduce the country's foreign policy options, especially on critical occasions. This may constrain a country's sovereignty in external relations.[45]

In addition to the internal problems faced by developing countries, there are also the consequences of the sale of developed country agricultural surpluses in developing country markets. The focus of USA farm policy has increasingly been directed towards gaining a foothold in new markets, particularly in South East Asia. It has been argued that the focus of USA farm policy is fostering dependence on USA imports within these countries.[46] Such dependence has been cultivated through the use of export subsidies, food aid and USA trade power. These strategies have now been enhanced by the liberalisation of South East Asian markets. A USA Department of Agriculture report on market potential in the Philippines states that in the absence of sustained, aggressive investment in infrastructure and increased competitiveness in grain production, the Philippines could become a regular grain importer by the end of the decade. The expectation of USA policy makers is that import liberalisation will considerably accelerate the conversion of consumer demand in South East Asia from locally produced staples such as rice, cassava and grains towards USA wheat. As wheat is not indigenous to the Philippines or currently viable as a commercial crop, the Philippines will become increasingly dependent upon the USA for its food staples. As access to food becomes more dependent upon money, poorer people are inevitably excluded from food markets and by, extension, from global food trade. International trade cannot change this in any meaningful way as it responds to market signals rather than human need. It has been argued that the dumping of surpluses generated by the capital-intensive food systems of developed countries has a highly destructive effect on the food systems of developing countries as it deprives small farmers of their livelihoods, depresses markets and undermines investment in agriculture. It also limits the variety of food available within the global system as developing country populations move away from their cultural and indigenous food choices to cheaper western diets. This reinforces the very structures of poverty behind global food insecurity

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45 Lal Das, op cit note 44.

46 Watkins (1997:37).

and erodes the capacity of people to grow their own food or to purchase it.[47]

The issue of food variety has also been linked to Article 27(3)(b) of the TRIPS Agreement. While developing country communities are increasingly being forced to adopt Western diet patterns as their own because of surpluses of these foods, there has also been the genetic adaptation of indigenous food varieties for the global market by multinational agri-business concerns. A good example of this is the case of Basmati Rice. Article 27 (3)(b) of the TRIPS Agreement requires governments to provide patent protection for microorganisms and biological processes involving them, which includes genetic engineering processes and genetically engineered animals and plants. Governments are also required to protect intellectual rights on plant varieties, either through patenting or through an effective *sui generis* system of protection.[48] There is considerable concern that the knowledge of developing country farmers and indigenous communities that are mainly responsible for developing crops and the use of plants will not be recognised, while corporations which genetically engineer biological resources will be rewarded instead. Developing countries may then have to purchase biotechnology products at high prices even though they are the source of the knowledge on the utilisation of the resources used in biotechnology. This could lead to higher costs of seeds and food products in developing countries.[49]

The liberalisation of markets within developing countries and the resultant increase of agricultural produce being sold on developing country markets have raised the economic issue of fair competition and a level playing field. The FAO advocates free markets on the basis that trade will allow domestic food consumption to be met more cheaply by less costly imported supplies. It is the FAO's view that the advantages of free trade are particularly marked for countries in which the overall availability of domestically-produced food staples is in decline, as increased imports will keep food prices low. To cover their food deficits, the FAO has recommended that developing countries open up their markets to foreign food producers and import developed country surpluses. It believes that the removal of any

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47 Watkins, op cit note 46.

48 WTO, op cit note 15 at 379.

49 Khor (1999:32).

domestic trade barriers will enable all countries to reap the benefits of comparative advantage and improve national economic performance by discouraging unproductive activities. Even though liberalisation will create adjustment costs for producers, such costs will be outweighed in the longer term by opportunities for export and the wider benefits of modernisation.[50]

The FAO view is not shared by many developing countries who state that agricultural production and trade are determined not so much by comparative advantage as by comparative access to subsidies. This is an area in which producers in developed countries enjoy an unrivalled advantage over developing country producers. Far from creating market conditions in which prices reflect the real costs of production, the removal of a country's trade barriers is actually deemed to distort markets by sending false price signals through the trading system, thus throwing smallholder food systems in developing countries into unequal competition with the heavily-subsidised, large-scale, capital-intensive agricultural systems of developed countries. Under such conditions, a level playing field cannot be said to exist.[51]

While advocates of trade liberalisation acknowledge that market distortions caused by subsidies exist, they argue that these distortions will become a thing of the past once agreements reached under the GATT 1994 are implemented. The new GATT rules require developed-country governments to reduce their trade distorting subsidies by 20 percent and to lower export subsidies by 36 percent in value terms and 21 percent in volume terms. This has resulted in a widespread perception that producers worldwide are now competing on a level playing field. This assumption is far from correct, however, as the "Green Box" subsidies mentioned earlier, a side agreement negotiated bilaterally between the EU and US, has left the structure of subsidies in developed countries largely intact. This agreement ensures that direct payments to farmers such as "set-aside" payments[52] should be exempt from the subsidy cuts agreed to under the main GATT Agreement on the grounds that these payments do not promote agricultural production and are thus not trade-distorting measures. These direct payments

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50 Watkins, op cit note 46 at 33.

51 Watkins, op cit note 46 at 34.

52 Where farmers are paid to withdraw land from production.

account for a growing proportion of subsidies provided for under the EU's Common Agricultural Policy (CAP) and are deemed production neutral. This view is not held by developing countries.

Direct payment levels are determined by a formula which is based on land-holding and average yields, both of which are production-related. Direct payments now account for 23 percent of agricultural subsidies in the industrialised countries - an increase of 5 percent over the 1986 base period. The majority of the increase is accounted for by the EU, whose 1992 CAP reforms shifted the focus of farm income support away from price interventions in the form of guaranteed prices for given commodities towards direct payments to producers. The exemption of these direct payments from the Uruguay Round Agreement has reduced the level of EU subsidy cuts required by over $3 billion in the case of wheat alone. In the USA, the Green Box subsidies have allowed production subsidies to continue. By the year 2000, subsidies of up to $16 billion would have been permissible. This is double the 1995 level of national government support. A wide range of additional subsidies are also exempt from reductions. These include $1,5 billion of public finance spent on USA research and development and $2 billion allocated for crop insurance. Both these areas have clear production linkages.[53]

The Green Box provisions also contain other elements which will further diminish the efforts of the Uruguay Round to reduce the use of trade-distorting subsidies. An example is the export reduction commitments. The reference period against which these reductions are measured for the EU is the 1991-1992 period rather than the standard reference period of 1986-1990. The level of subsidy in 1991-1992 was much higher than in 1986-1990. The agreement now allows the EU to export over eight million more tons of subsidised cereals than would otherwise have been possible. In addition, the commitment to reduce the volume of subsidised exports by 21 percent means that 79 percent of subsidised exports are still allowed under the new GATT rules. This hardly allows for a level playing field or proper competition between developed and developing economies.[54] While the Agreement on Agriculture tackles the issue of subsidisation and direct price support, the fact remains that the developed economies still have the option and resources available with which to support their

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53 Watkins, op cit note 46 at 35.

54 Watkins, op cit note 46 at 45-46.

domestic producers, thus reducing the price of their exports. Very few developing countries have such resources available. As a result, developing countries must compete against unnaturally low-priced agricultural exports from developed economies.

While net food importing countries have benefited from less-subsidised developed country exports, exporters from developing countries seeking entry into developed country markets are at a distinct disadvantage. Exports in which developing countries have a comparative advantage, *ie* fruits, vegetables, sugar and other non-grain crops, are at a distinct disadvantage because their comparative advantage is eroded not only by subsidised domestic goods but also by tariff barriers and non-tariff barriers such as phyto-sanitary measures, quotas and voluntary export restraint agreements.[55] These developing country exports have continued to face high protection in developed economies even after implementation of the Uruguay Round, mainly on a seasonal basis. Entry at lower tariff levels is only allowed when there is no domestic production.[56] While the Agreement recognises that subsidies and other protectionist measures are trade distorting, it has not gone far enough to remove the distinct disadvantage which the developing economies face when trading their agricultural goods within developed country markets. While the Agreement has made some effort to reduce the developed countries' ability to protect their markets, developed countries are still able to provide alternative protection through Blue and Green Box measures, the safeguard provision and other non-tariff barrier measures. Even though the Agreement differentiates between developed and developing country obligations and positions, the differentiation has not been one which places the developing economies in a much better position than they were in before as their most competitive exports still face prohibitive protectionist measures.

6.4.2 Objections against the Agreement on Agriculture

Developing countries have acknowledged that the Agreement on Agriculture has both positive and negative features. They have praised the Agreement for the serious beginning which it has made in

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55 Diao, Roe and Samwaru (2002:13).

56 Diaz-Bonilla, Robinson, Thomas and Yanoma (2002:29).

bringing agriculture into the normal discipline of international trading rules. A unique feature of the Agreement is the fact that even such measures as subsidies have been covered by the specific commitment of yearly reductions. In other agreements, only tariffs have been given such coverage. Despite praise of the Agreement, many deficiencies and imbalances have been found with individual provisions.[57]

The first complaint is against the *de minimis* obligations of developing countries in Article 6(4)(b) and Article 7(2)(b). Article 6 requires countries which have been using measures for import restraint and domestic support to reduce the levels of support respectively by 36 and 20 percent. The budgetary outlay and quantity of exports covered by export subsidies must be reduced by 36 percent and 21 percent respectively. For developing countries the levels are two thirds of these percentages. As a result, countries using these measures are able to retain a large percentage of the measures up to the end of the implementation period. Those countries which had not been using these measures prior to the Agreement are, however, prohibited from using them in the future, beyond the *de minimis* limits. This provision has been deemed patently unfair as countries distorting the market in the past are allowed to continue their trade distorting behaviour to a significant extent, whereas those who had refrained from doing so in the past[58] are completely prohibited from using these measures in the future.[59]

Another difficulty with the Agreement stems from the nature of farming in developing countries. In many such countries, agriculture is not taken up as a commercial venture, although small groups of commercial farmers do exist. Many farmers began farming when they received land in the form of ancestral property and have no other profession. There are thus large numbers of subsistence and small farmers in developing countries. It is therefore very difficult to harmonise the special characteristics of developing countries with the operation of the price mechanism and commercial nature of agriculture, which are the basic provisions of the Agreement on Agriculture. The exposure of these

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57 Lal Das, op cit note 44 at 24.

58 Not necessarily from conscious choice but often due to a lack of available domestic funds.

59 Lal Das, op cit note 57.

farmers to international competition in agricultural products could threaten the livelihood of these farming households on a colossal scale.[60]

While the issue of tariffication was welcomed by all parties, developing countries have complained about the high tariffs adopted by some developed countries.[61] Another developing country complaint is against tariff quotas.[62] Beyond the tariff quota, imports are subject to the ordinary tariff rate. The Agreement on Agriculture provides that tariff quotas may be allocated for the following purposes: current access opportunities, general minimum access opportunities and minimum access opportunity as a result of special treatment. Current access opportunities refer to the provision of the opportunities for annual imports equal to the average annual imports for the years 1986-1988, as well as the protection of import opportunities in bilateral or plurilateral agreements. General minimum access opportunities refers to the provision of the opportunity for imports up to a minimum percentage of domestic consumption in the years 1986-1988. Tariff quotas allocated for current access opportunity and general minimum access opportunity have been criticised by developing countries. The tariff opportunities discussed above have to be provided by low tariffs up to a certain quantity of imports. Tariff quotas used to protect the access resulting from bilateral or plurilateral agreements will naturally be country specific. For other cases of access opportunities, however, the tariff quota should be global, not country specific to countries, so that all countries have the opportunity of utilising them. With tariff quotas in agriculture, however, some developed countries have mixed up the various elements of access opportunity and have literally provided for country-specific tariff quotas. Other countries do not therefore get the possibility of utilising these access opportunities.[63]

Developing countries have also complained about the uncertainty regarding specific domestic support. Members have committed themselves to limit domestic support within the ceiling mentioned in the schedule. A country can moderate the choice of the product and the rate of subsidy, depending on its

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60 Lal Das, op cit note 57.

61 Lal Das, op cit note 57.

62 Sometimes countries allow imports up to some quantity at comparatively low tariff levels, when ordinary tariffs are high. These quantities are called tariff quotas.

63 Lal Das, op cit note 44 at 25.

own need.[64] This results in uncertainty for exporters in other countries which have a handicap in planning their own exports.[65]

The subsidy provided by developing countries for the purchase of food for stocking and public distribution is exempt from reduction commitments. The difference between the purchase price and the external reference price must, however, be included in the calculation of the Aggregate Measure of Support (AMS). The Annual Bound Commitment Level of the AMS is mentioned in a country's schedule and it signifies the level above which support cannot rise for that year. A country choosing to subsidise the food purchased for stocking will have to reduce subsidies on some other items so as to limit the subsidy to the bound level of the AMS in that year. While subsidies for the purchase of food for stocking and public distribution are exempt from domestic support reduction commitments, the fact that these subsidies have to be included in a country's AMS calculation, means that they will affect the ability of developing economies to subsidise other agricultural endeavours. While subsidies for food purchases are meant to be exempt from reduction commitments, they do actually affect developing country reduction commitments as their increased use will affect the overall subsidy structure of developing countries. As a result a provision which appears to favour developing countries is actually not doing so.[66]

Finally, developing countries have complained about discrimination in the due restraint provision. The Agreement on Agriculture provides for due restraint on action against subsidies, with two categories of subsidies being affected. One set is covered by Article 6[67] and includes items like the investment and input subsidy of developing countries. The other set is covered by Annex 2 of the Agreement and includes items like government services programmes, direct payment to producers, income insurance programmes, crop insurance programmes and structural adjustment assistance. The due restraint provisions enable these two categories to be treated differently. Annex 2 subsidies, generally prevalent

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64 Article 9(2), WTO, op cit note 15 at 48-49.

65 Las Das, op cit note 63.

66 Lal Das, op cit note 63.

67 This article refers to domestic support commitments.

in developed countries, have been exempt from countervailing duties and countermeasures. Article 6 subsidies, which apply mainly to developing countries,[68] do not have such an exemption. All that has been mentioned is that due restraint should be shown in initiating countervailing duty investigations.[69] This provision, however, is in the nature of a suggestion and not an obligation.[70]

6.5 Does the Agreement on Agriculture discriminate against developing economies?

The Agreement on Agriculture, because of the nature of negotiations, is an agreement which caters mainly for developed country interests. Not much was asked from developing countries and very small concessions were made to meet developing country needs. Where concessions have been made to developing economy interests, the nature of these concessions will be analysed to determine whether the Agreement differentiates between the interests of developed and developing economies. Articles 15 and 16 of the Agreement on Agriculture[71] provide for preferential treatment of developing state economies. Article 15(1) provides that such differential treatment is an integral part of the Agreement on Agriculture and is provided for in relevant parts of the Agreement. While developing country Members have flexibility to implement reduction commitments over a ten year period, least-developed countries are not required to undertake reduction commitments. Developed countries have also committed themselves to take action as provided for within the framework of the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries.[72]

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68 Article 6(2), WTO, op cit note 15 at 46.

69 Article 13(b)(i), WTO, op cit note 15 at 51.

70 Lal Das, op cit note 44 at 25.

71 WTO, op cit note 15 at 53.

72 WTO, op cit note 15 at 448.

Ministers who were party to this Decision have agreed to initiate negotiations in the appropriate forum to establish a level of food aid commitment sufficient to meet the legitimate needs of developing countries during the reform programme. The Ministers also agreed to adopt guidelines to ensure that an increasing proportion of basic foodstuffs is provided to least-developed and net food-importing developing countries fully in grant form. In addition, Ministers would give full consideration in the context of their aid programmes to requests for the provision of technical and financial assistance to least-developed and net food-importing developing countries to improve their agricultural productivity and infrastructure. Where implementation of the Uruguay Round leads to certain developing countries experiencing short term difficulties in financing normal levels of commercial imports, Ministers have agreed that these countries may be eligible to draw on the resources of international financial institutions under existing facilities, or facilities which may be established, in order to address financial difficulties.[73]

Differential treatment of developing economies extends to domestic support commitments as well. Government measures of assistance, whether direct or indirect, which encourage agricultural and rural development are seen as an integral part of development programmes of developing economies. Accordingly, investment subsidies which are generally available to agriculture in developing country Members and agricultural input subsidies generally available to low-income or resource-poor producers in developing country Members are exempt from domestic support reduction commitments that would otherwise be applicable to such measures. Also exempt is domestic support to producers in developing country Members where this support encourages diversification from growing narcotic crops.[74] With regard to calculation of current total AMS, developing country Members are not required to include in this calculation product-specific and non product-specific domestic support where such support does not exceed ten percent of that Member's total production value of a basic agricultural product during the relevant year of that Member's total agricultural production, respectively. For developed country Members the *de minimis* percentage is five percent.[75]

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73 WTO, op cit note 15 at 448-9.

74 Article 6(2), WTO, op cit note 15 at 46.

75 Article 6(4), WTO, op cit note 15 at 46-47.

Where the Agreement on Agriculture makes provision for developing country needs, there is recognition of differences between developed and developing country Members. In cases where the Agreement places an obligation on developed economies to make provision for food aid to developing economies, the Agreement may be seen as having a negative impact on developed economies as it places responsibilities upon them which they may not have previously had.

GATT Members who were party to the Agreement on Agriculture, agreed that in implementing their commitments on market access, developed country Members would take fully into account the particular needs and conditions of developing country Members by providing for a greater improvement of opportunities and terms of access for agricultural products of particular interest to developing country Members. This would include the fullest liberalisation of trade in tropical agricultural products as agreed at the Mid-Term Review and for products of particular importance to the diversification of production from the growing of illicit narcotic crops. Members also agreed that food security concerns and special and differential treatment for developing countries were integral elements of negotiations.[76] Discrimination between developed and developing economies was therefore based on the particular needs and conditions of developing economies. The purpose of discrimination is to provide greater market access to developing country goods, address concerns about food security and ensure that developing economies are able to implement their obligations under the Agreement properly. Given that very real differences exist in the approach towards agriculture in developed and developing economies, with these groups of states being at very different places with regard to the development of their agricultural sectors, the reasons given for discrimination between these groups of states are relevant and necessary.

While a rational connection can be found between the discrimination and a legitimate GATT purpose, the discrimination must also be proportional, that is, the means used must justify the ends sought to be achieved. Other than food security, and domestic support commitments, the special treatment to be extended to developing economies refers to implementation of the Agreement on Agriculture. Developing economies have ten years to implement their reduction commitments while least-

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76 WTO, op cit note 15 at 39.

developed economies are not required to undertake any reductions.[77] Given that a large part of the Agreement on Agriculture refers to reduction and elimination of trade-distorting subsidies, the reduction commitments to be made by developing country Members will be subsidy related, linked to tariff reductions or decreasing barriers to access by foreign agricultural exports. Whereas the developed economies had the resources to subsidise their agricultural sectors, very few developing economies were able to. With their labour intensive agricultural products, food-exporting developing economies were most likely to be facing export barriers instead of implementing them. With net food-importing countries, many of the issues which concerned developed country Members were of no real interest, except where they would impact on the price of agricultural produce and the extent of food aid received.

Even where developing economies are permitted to maintain current levels of domestic support, such support is unlikely to impact negatively on developed agricultural goods because of the level and type of support provided.[78] Discrimination between developed and developing country Members is internally, as opposed to externally, focused, with allowances being made to protect the developing economies from the negative impact of provisions within the Agreement. Because of the differences in the development of developed and developing countries agricultural sectors, there is very little possibility of the allowances which were made to developing economies having an unduly negative impact on developed country economies. The discrimination is therefore proportional, with the means employed justifying the ends sought to be achieved.

While the discrimination is both rational and proportional, the question of efficiency remains. The agricultural sectors of developed economy Member states have long been protected by very high tariff rates, export subsidies and production subsidies, both direct and indirect. Protection has limited access by developing country agricultural exports into developed country markets and allowed developed country producers to bring about artificially low prices for global agricultural producers. While artificially low agricultural prices have benefited net-food-importing developing states, these prices,

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77 Article 15(2), WTO, op cit note 15 at 53.

78 See section 6.4.1.

together with restricted market access to developed markets, have inhibited the growth of agriculture and related industries within developing states. While the Agreement on Agriculture makes an effort to address production and export subsidies, the exemption of direct payments to producers and Green Box subsidies have enabled developed Member states to shift their focus to exempt subsidies. As a result, subsidisation of producers has continued, either through direct payment to producers or production subsidies allowed by Green Box provisions.[79] The exemptions allowed by the Agreement on Agriculture effectively undermine the aim of Member states to liberalise agriculture.

With regard to tariff bindings, the fact that all Member states have agreed to bind tariffs on very sensitive agricultural goods does not mean that tariff protection on agricultural produce has fallen in any way as the applied tariff rates and not bound rates are what matter. On the other hand, the conversion of non-tariff barriers into tariff rates, while not necessarily resulting in less protection, allows for greater transparency and certainty in trade between states as exporters will have more knowledge of the type of protection which they face and the rate of tariff protection on goods. While the fact that agriculture now comes under the GATT is a step forward, very few real changes were made which facilitate the growth of developing economy agricultural sectors. The Agreement still permits high levels of protection of developed markets through tariffs and/or subsidies. Liberalisation of agriculture has been minimal, with the goal of liberalised freer agricultural markets still a long way coming. From an economic view of efficiency, the Agreement on Agriculture still permits developed and some advanced developing economies to subsidise their agricultural sectors, thus protecting their domestic sectors at the expense of non-subsidised labour-intensive developing agricultural products. This means that some countries are able to further their interests at the expense of other countries' development. This is neither a win-win situation nor is it Pareto-efficient.

The Agreement on Agriculture does not really address issues such as redress. While the Agreement places an obligation on developed states to provide increased food aid to net-food-importing state aid has been decreasing.[80] Developed economies are also obliged to provide technical and financial

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79 See section 6.4.1, footnote 53.

80 See footnote 37 and 38 of this chapter.

assistance to least-developed and net-food-importing developing countries to improve their agricultural productivity and infrastructure. This provision, while it places a positive obligation on developed states to assist developing states, is not specific enough, as it does not expand on the level and extent of technical and financial assistance to be provided to the affected developing countries. Developed states are therefore at liberty to decide how they will assist the developing states. There is very little within the Agreement to suggest that developed states are really obliged to address the needs of the developing economies or give the interests of developing countries any real priority. Redress usually occurs through compromise and sacrifice. The Agreement on Agriculture makes no provision for the sacrifice of developed country interests where this will assist developing countries. Discrimination within the context of this Agreement is therefore very superficial and makes no provision for economic or legal efficiency.

The Agreement on Agriculture, despite the gains made through tariff bindings and the elimination of most non-tariff barriers to trade, maintains the *status quo* with developed economies still being permitted to protect their economies and dictate the terms of agricultural liberalisation. Where concessions are made to development, they impact very little on developed country monopoly power or depend on developed country benevolence. Developing countries remain dependent on developed economy goodwill for access to markets, food aid and security, financial and technical assistance. Very little has been provided for within the Agricultural Agreement which will contribute towards the autonomy of developing country agricultural trade or provide developing countries with the leverage which they need to obtain economically efficient outcomes for their agricultural sectors. Because little effort has been made to empower developing economies to address their problems with market access, infrastructure, growth and development and subsidies, the Agreement on Agriculture cannot be deemed to address issues of power between developing and developed economies. Because fairness requires both efficiency and provisions which result in powerlessness between states, the discrimination cannot be seen as fair. Even though the Agreement on Agriculture is the first effort by Member states to address the agricultural sector, the fact that it does not address developing country concerns with any real commitment makes it unfair.

6.6 Conclusion

The Agreement on Agriculture, despite its lofty aims, has had rather disappointing outcomes as agriculture remains one of the most highly protected and subsidised sector in developed states. In terms of its focus on developing country interests, very little emphasis has been placed on addressing developing country concerns. This is a very unfortunate outcome, as agriculture remains a sector in which net food-exporting developing countries have a distinct comparative advantage in labour-intensive agricultural products. It is these products, however, which are subject to prohibitive tariffs and other trade barriers which undermine their competitive advantage. Protection of developed country farmers has cost developing country agricultural producers dearly and prevented developed country consumers from obtaining cheaper agricultural produce. While it may be argued that subsidisation of farm producers contributes towards food security and lower global prices, the costs of a subsidisation are ultimately carried by consumers in developed countries and developing country producers. Until developed country governments agree to liberalise their agricultural sectors, agriculture will not only be trade-distorting but also discriminate unfairly against developing country interests.

Chapter 7

Foreign direct investment, TRIMs and unfair discrimination

7.1 Introduction

Access to foreign capital through direct investment by foreign firms, especially transnational companies (TNCs) has become important to developing countries growth[1] Given the limited amount of available capital and the competition for capital-rich investment by developing and developed economies, countries have embraced some highly competitive practices to attract TNCs. While states seek to attract and keep TNCs and their capital, the TNCs seek more lenient repatriation laws and have adopted some restrictive business practices to ensure that they are able to repatriate profits and, where possible, capital to their parent states. This has resulted in states implementing trade-related investment measures (TRIMs) which seek both to attract foreign firms and prevent the use of restrictive business practices. This chapter focuses on FDI, TRIMs and the impact of the Agreement on TRIMs on developing economies. More specifically, the chapter seeks to determine whether the Agreement on TRIMs discriminates unfairly against developing economies.

7.2 Foreign direct investment (FDI)

FDI has been defined by the World Trade Organisation (WTO) Secretariat as occurring "when an investor based in one country (home country) acquires an asset in another country (host country) with the intent to manage that asset".[2] A more descriptive definition of FDI is the investment of money, goods and services in an economic venture, especially establishing subsidiary companies or the take-over of foreign companies.[3] FDI also incorporates the infusion of new equity capital such as a new

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1 McCulloch, Winters and Cirera (2001:354). Foreign direct investment potentially offers developing countries access to finance, technology, design and marketing outlets.

2 Burt (1997:1019).

3 Voss (1982:686).

plant or joint venture (where multinational corporations obtain equity holdings[4] in host country corporations with powers of management and control) and where TNCs make long-term loans with low or partnership-type interest rates to host country corporations for equity holdings within these corporations.[5] FDI is distinguishable from portfolio investment, where foreign investors buy securities[6] in host country companies solely for a financial return, and other capital investment such as the purchase of real estate. With portfolio investment, the foreign investors' interest in the host country is purely speculative, with no intention to own, control or manage a domestic firm.[7]

FDI has been growing at a considerable rate. Total FDI inflows into host countries in 1995 amounted to $315 billion, a 40 percent increase over 1994. Of these inflows, developing countries received $100 billion in 1995.[8] FDI inflows to developing countries represented a third of global cross-border intra-firm investment - $158 billion out of $489 billion in 1996-8. Most of this investment has gone to just six developing countries: Brazil, China, India, Indonesia, Mexico and Korea.[9] World FDI inflows increased dramatically for the period 1999 and 2000. For 1999, FDI inflows to developed countries amounted to $830 billion. Developed countries received $222 billion. Developed countries received $1005 billion in FDI inflows for 2000, while developing economies received $240 billion in FDI inflows.[10] While FDI inflows to developing countries have increased, developed economies remain the primary recipients of these inflows.[11] The issue of FDI is therefore not just a North-South issue,

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4 Trebilcock and Howse (1999:335) Equity holdings referred to is the value of the shares issued by a company (Hornsby 1995:389).

5 Voss, op cit note 3. A 25 percent holding usually constitutes control.

6 Other types of portfolio investment include capital shares in businesses without controlling interest, bank loans etc (Voss, op cit note 3 at 686).

7 Trebilcock and Howse, op cit note 4 at 335. For more on portfolio investment and the control of TNCs , see Wallace (1983:141-174).

8 Burt, op cit note 2 at 1019.

9 McCulloch et al, op cit note 1 at 355.

10 Murodzikwa (2002:4).

11 See footnotes 13 and 14.

as TNCs from industrialised and developing countries have been relocating to industrialised and developing host countries. We therefore find North-North,[12] North-South,[13] and South-North,[14] FDI.

TNCs undertake FDI for many reasons. By relocating to a host country an TNC can enhance product competitiveness through tariff-jumping FDI.[15] Where protectionist regulations prohibit direct importing[16] by host countries, tariff-jumping FDI may occur. Exporters of goods are also forced to shift their operations to countries which erect trade barriers. Japanese investments in the United States, Canada and the European Community, especially in the consumer electronics industry, have been linked to trade-barrier-jumping[17]. Essentially, TNCs may choose to locate subsidiary companies within the host country to escape prohibitive specific and *ad-valorem* taxes of the host state and so maintain or gain an advantage over competitors. While the main motivation for TNCs is profitable investment opportunities, FDI also occurs because TNCs are attracted to cheaper labour for production facilities, due to the supply of natural resources and as a result of investment incentives offered by host countries seeking to attract long-term foreign capital.[18]

FDI has accordingly been classified into four types: efficiency, market, natural resource and strategic asset-seeking FDI.[19] Efficiency FDI is aimed at increasing the efficiency of TNC activities by integrating assets, production and markets. Natural resource and strategic asset- seeking FDI are

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12 Which is the most prevalent form of FDI.

13 An example is the investment of Singaporean, Korean and Taiwanese TNCs in Malaysia, Indonesia and Thailand. See OECD (1994:4).

14 While there is very little South-North FDI, the relocation of Korean automobile TNCs to the EU qualifies, OECD, op cit note 13 at 4.

15 Burt, op cit note 2 at 1020.

16 Morrissey and Rai (1995:705).

17 Ariff (1989:361). Where much of an TNCs comparative advantage is portable, eg it consists of knowhow, processes and technology, companies may avoid border restrictions by manufacturing within the domestic market. This provides the TNC with enhanced access to domestic markets. See Trebilcock and Howse, op cit note 4 at 340.

18 Burt, op cit note 2 at 1020.

19 Streak (1998:14).

driven by the attempt to acquire resources and capabilities that an investing firm believes will sustain or enhance its core competencies in regional or global markets. Market-seeking FDI is influenced primarily by the size, structure and growth of local and common markets, economies of scale, host government policy towards imports, transport costs and political and economic stability in the potential host relative to similarly situated countries within a particular locality. Resource and efficiency-seeking FDI are attracted by the availability and cost of natural resources and labour, the productivity and skills of human resources, the extent and quality of local technological and communications infrastructure, the efficiency of governmental institutions, external economies generated by industrial districts, the value of the exchange rate, proximity to leading export markets, the extent to which trade (including trade in intermediary products) is free between home and host countries, and between host countries in which foreign affiliates of TNCs are located,[20] tax and other incentives. A host country's created assets, including the innovatory capacity of firms, attract asset-seeking FDI.[21]

FDI, depending on its nature and the economic conditions of the host country, has many potential benefits for the economy of the host country. These may include the injection of needed capital, the introduction, transfer or spillover of technology, introduction of sophisticated management skills, increased host country employment, increased competition in host country markets and increased foreign exchange earnings through TNC exports, amongst others.[22] However, FDI, when left uncontrolled, can negatively affect the host country and disrupt the host country's development policies.[23] This occurs where the resources of the host country are misdirected in the investor's interests. An example is the substitution of domestic economic activities such as project financing in the local capital market and the substitution of less competitive local enterprises with foreign companies. The introduction of capital-intensive production in developing countries dependent on labour-intensive industries results in the worsening of the employment structure. Exorbitant profits

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20 This is linked to the cost of imported inputs.

21 Streak, op cit note 19.

22 Burt, op cit note 2 at 1021.

23 Burt, op cit note 2 at 1022. See also Morrissey and Rai, op cit note 16 at 702-705.

made by TNCs or the combination of direct investment with the compulsory import of expensive technology packages can aggravate balance of payments difficulties in the host country. FDI may also result in the production of goods which are inadequate in terms of demand, *ie* luxury items may be produced instead of articles satisfying basic needs.[24] In addition to the disruption of the host country's development policies, TNC control or domination of host country sectors can interfere with host country social and economic reforms. The repatriation of TNC profits to the parent company in the home state can deplete the host's foreign exchange reserves. TNCs may also introduce environmentally destructive or hazardous technologies into the host country.[25]

The relationship between TNCs and their host countries is therefore an ambivalent one. While industrialised and developing host countries welcome the injection of long-term foreign capital into their economies, they are careful to regulate and control the type of FDI which enters their domestic territories. These regulations protect indigenous industries and ensure that profits made by TNCs are not all repatriated. The regulations imposed by host governments to control restrictive business practices have been defined as trade-related investment measures (TRIMs). It is important to note that while TRIMs and corresponding services provisions are applied to deal with restrictive business practices, their application is not limited to restrictive business practices. Not only do governments have their own specific development agendas, investment measures are also imposed to attract FDI, such as investment incentives, and coerce TNCs to comply with host government objectives, for example, technology transfer. It is in this sphere that the protection of patents and trademarks becomes important and the GATT Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) becomes important to the FDI issue.

While a determination of the impact of FDI and the TRIMs Agreement on developing countries appears to suggest a developed-developing country split, this is not an issue which can be neatly divided into North-South camps. Ariff,[26] in his analysis of the North-South divide, states that the

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24 Voss, op cit note 3 at 689.

25 Burt, op cit note 21.

26 Ariff, op cit note 17 at 350. The TRIPS Agreement will be considered in Chapter 8.

divide between developed and developing countries appears to be a reflection of the direction in which capital tends to flow, *ie* from developed to developing countries, and the differences in the perceptions of home countries as opposed to host countries.[27] Ideally capital should flow from capital-abundant countries to capital-deficient ones. Developed countries should therefore act as suppliers of capital, with developing countries being the recipients. The relationship between trade and investment is more complicated as, in the real world there is no free trade, nor is capital mobile internationally. Capital movement and trade flows, in the global market, can and do complement each other. Ariff observes that capital moves between countries not only in search of higher returns but also in tandem with trade flows. Because trade is not free or costless, it has not replaced the need for capital movements altogether. As a result, returns on capital cannot be equalised internationally.

Economic theory supports the idea that developed countries can be both sources of and hosts for FDI. TRIMs are therefore of interest to developed countries as both suppliers and recipients of foreign direct investment. With developing countries, the situation is essentially the same, although most developing countries are recipients of FDI. FDI has occurred in the form of offshore operations in the export-processing zones[28] of some developing countries. Domestic market-oriented investment by foreign enterprises is frequently closed to foreigners. Foreign investment in export-oriented manufacturing is often encouraged, however, by offering export-oriented firms fiscal and other incentives such as automatic approvals, land-ownership, full control of affiliate companies, tax holidays and duty free imports of components.[29] These benefits and incentives are trade-distorting. Countries such as the Republic of Korea, Taiwan, Hong Kong and Singapore[30] have been investing

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27 Ariff, op cit note 26.

28 Export-processing zones are areas set aside in developing countries for the promotion and production of export-oriented goods. Foreign investors were generally prohibited, in many developing countries, for example, Malaysia, from owning land, except for investments in export processing zones. This is one way in which developing country governments encourage export-oriented foreign direct investment. See OECD, op cit note 13 at 19-21.

29 OECD, op cit note 13 at 20.

30 Singapore is now classified as a developed economy. It must be noted that the newly-industrialised countries are not the only developing economies who have invested heavily in foreign countries. South African companies have also been involved in FDI in both developing countries and developed countries. A recent example is South African Breweries (*www.oecd.org)* (12 August 2002), OECD (2002:10).

abroad, in both developing and developed countries. For these countries, their interest in TRIMs issues is similar to that of their developed country counterparts.[31]

Despite the exceptions to the rule, the majority of developing countries are host countries. To many of these countries, the attraction and maintenance of FDI constitutes the only means of attracting the non-loan capital necessary to pursue development policy objectives without sacrificing their sovereign authority. The World Trade Organisation's foray into the sphere of investment policy is therefore seen as a threat. Developing countries, led by India, protested the inclusion of investment measures within the WTO and the multilateral efforts to regulate direct investment, as they view restrictive investment policy as a sovereign right and an element of national economic policy. They fear that TNCs, if left unregulated, will abuse their power by applying restrictive business practices. They also feel that the liberalisation of investment policies will result in the loss of sovereign control over national development.[32]

While development and the protection of sovereign rights are important issues in the investment debate, the real war is being fought against protectionism. Of the $1245 billion total FDI inflows in 2000, only $240 billion reached developing countries. The remaining $1005 billion was received by the Organisation for Economic Cooperation and Development (OECD) countries.[33] The interest of developed countries in the removal of trade-related investment measures and the subsequent liberalisation of trade is a legitimate one. By including investment measures within the ambit of GATT 1994 legislation, OECD countries are attempting to remove some of the remaining non-tariff barriers to free trade and ensure easier access for their products and companies to the domestic markets of host OECD countries. While developing countries have legitimately protected their domestic markets in order to foster development, developed country use of TRIMs has, in many cases, been deemed protectionist. By including TRIMs and GATS within the WTO framework, developed countries therefore hope to promote greater openness in global trade at all levels.

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31 Ariff, loc cit note 17.

32 Burt, op cit note 2 at 1017.

33 Burt, op cit note 2 at 1019.

7.3 Trade-related investment measures (TRIMs)

Although states have adopted investment measures to reduce or eliminate restrictive business practices, these are not the only reasons for the implementation of investment measures. Restrictive business practices are, in fact a very small reason why host governments adopt and implement investment measures. States generally consider TRIMs to be important components of broader economic policy regimes designed to pursue goals such as industrialisation through import substitution, technology development and diffusion, skill acquisition and entrepreneurship, local employment, regional development and export expansion.[34] There may therefore be clear linkages between TRIMs and broader policies, such as infrastructure provisions and commercial regulation. An example would be where performance requirements are imposed on subsidiaries of multinational companies in order to redirect the rents that these firms would enjoy from a local market protected by import barriers. Distinct policy objectives are often listed as motivations for TRIMs. States may be motivated to maintain a degree of policy sovereignty and local control over rents from indigenous resources. Other motivations are industrial development, including industry structure and firm size, technology transfer and mitigation of difficulties in the balance of payments. TRIMs may also be used as countervailing measures in cases where home countries block market access for exports from host countries through commercial policies.[35]

Greenaway[36] divides the functions performed by TRIMs into three distinct groupings. These are, first, to shape the allocation of resources in the host country; second, to ensure that the likelihood of benefits which the host government wishes to secure are greater than would be otherwise; and third, to redistribute the surpluses generated by FDI away from the TNC and towards host country residents. He refers to these functions as the resource allocation target, the insurance target and the rent-shifting

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34 Maskus and Eby (1990:524).

35 Maskus and Eby, op cit note 34 at 524-5.

36 Greenaway (1992:146).

target respectively.[37] The need to influence resource allocation is seen as the most obvious objective behind any investment policy. Investment incentives and disincentives are employed not only to attract FDI *per se* but also to influence the sectoral and geographical location of the investment. While investment packages are dependent on the industrial and regional policies of host governments, they are often used to steer mobile capital into particular locations and/or specific sectors. Host governments may therefore see local content requirements as a mechanism for raising employment levels or a local hiring target as an instrument of human capital formation.[38]

The insurance target is motivated by a host government's suspicion of the activities of a TNC and the difficulties in monitoring its performance. TRIMs can be seen as a mechanism for securing credible policy commitments. An example is the use of local content requirements to ensure that the investment does not result in a screwdriver plant[39] being set up. All things being equal, governments hope that this will result in employment being higher than it otherwise would be. Local sourcing of inputs can also contribute to the formation of physical and human capital. Those are objectives which research and development requirements and local equity participation are meant to achieve. They can thus be seen as means whereby commitments by TNCs to technology transfer, especially through the training of local manpower, are realised. Instruments meant to achieve the insurance target can therefore be seen as instruments introduced by governments sceptical of leaving things to market forces, and anxious to ensure that the intended resource allocation effects of the contract with the TNC are realised. In addition to securing insurance targets, TRIMs are used by host governments to redistribute part of the surplus generated by FDI[40] away from TNCs and towards domestic residents.[41]

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37 This chapter refers to the economic rationale for TRIMs. Non-economic reasons for the imposition of TRIMs also exist. These are defence and national security, inadequate regulatory or political control over the foreign investor and extraterritorially. Because the GATT refers only to border measures *ie* those measures which are meant to be trade-distorting, these measures are not relevant to the discussion. For more on these measures, see Trebilcock and Howse, op cit note 4 at 342-47.

38 Greenaway, op cit note 36.

39 Screwdriver plants are those where the host country is used as an assembly point for the final product. The product is imported in parts and put together in the host country, without any additional value being added to the product.

40 Brazil is an example of the dramatic increase in profits made by TNCs in developing countries. While TNCs repatriated profits of about $600-$700 million in 1993, this figure had risen to $7.5 billion in 1998, indicating the scope for rent-seeking behaviour by the Brazilian government. This

In order to understand the role of the rent-shifting target it is important to understand the relationship between incentives for TRIMs and protection. TNCs engage in FDI when the net benefits of doing so exceed the net benefits of alternatives such as arms-length trade or licencing. Reasons for engaging in FDI also include policy-induced characteristics like government incentives. A World Bank study on the subject found that managers in two-thirds of the projects surveyed reported that the location decision was affected by incentive policies.[42] These took the form of cash grants, tax holidays, duty remission on imported inputs, subsidised inputs or inducements for foreign investors to locate facilities in the host country. These incentives are generally offered to offset the negative effects of the various performance requirements imposed on TNCs.[43] The non-transparency achieved through the application of multiple and possibly contradictory policy instruments could benefit both the host country and the foreign firm.[44] The availability of multiple incentives and disincentives can enhance the host country's ability to extract a larger share of the profits obtained by the TNC. Foreign firms benefit as the application of multiple policy instruments enables the firms to conceal from competitors and the public the extent of preferential treatment received. The value of the incentives offered are often very generous as countries compete for a limited pool of capital. TNCs may also be attracted to a protected market as a sheltered market could provide greater profit-making opportunities. Incentives and protection make an attractive combination in the host market as they raise the net benefits of inward investment and provide economic rents to TNCs. TRIMs enable host governments to alter the distribution of these rents as the benefits provided through one set of instruments can be reclaimed, in part, by another set. In this way, host governments achieve their rent-shifting target.[45]

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figure could also be indicative of the failure of the government's investment measures in achieving their rent-shifting target (Khor 1999:43).

41 Greenaway, op cit note 36 at 147.

42 McCulloch (1990:554). For a more detailed explanation of investment incentives and their relationship with TRIMs, see McCulloch pp 545-551.

43 Maskus and Eby, op cit note 34 at 527. See also Greenaway, op cit note 36 at 148.

44 McCulloch, op cit note 42.

45 Greenaway, op cit note 43.

7.3.1 Types of trade-related investment measures

TRIMs have been classified according to whether they are input-output and or factor-commodity based. Greenaway[46] provides a comprehensive list of TRIMs using the input-output distinction.[47]

7.3.1.1 Input TRIMs

Input TRIMs include local content requirements, trade balancing requirements, laws of similars, limitations on imports, foreign exchange restrictions, local equity requirements, expatriate quotas, local hiring targets, national participation in management, research and development requirements and technology transfer. Local content requirements are the most widely used investment measures. These measures specify that some proportion of value added, or of intermediate, inputs must be obtained from the host country. Where local inputs cost more than identical imported inputs, this instrument has obvious trade effects.[48] There are many forms of trade balancing requirements. An example would be where the import of one product, an input, for example, is linked to a specified performance on exports of some other product, which could be the final good. Generally trade balancing requirements link imports of one product to export performance of some other. With laws of similars, foreign investors are required to use local substitutes for imported inputs if a "similar"[49] component is

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46 Greenaway (1990:369).

47 The classification of these measures has been necessary in order to determine their trade distorting effects. Such classification has proved difficult because investment measures may impact directly on both imports and exports. TRIMs which do not fit neatly into any category have to be put into a residual category, as they have "various" effects. The input-output distinction refers to measures affecting primarily imports and exports respectively. This distinction has been deemed important for several reasons. Firstly, TRIMs simultaneously perform the function of incentive and disincentive *eg* local content protection provides an incentive to local producers of intermediates, while simultaneously providing a disincentive to producers of final goods using the input. The input-output classification approach makes the identification of economic effects more straightforward. The input-output classification does not prevent the use of the commodity based/factor based distinction. See Greenaway, op cit note 46 at 368 and 369.

48 Loc cit.

49 Articles 15(2) of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994, WTO (1994:206), defines identical and similar goods. Identical goods are goods which are the same in all respects, including physical characteristics, quality and reputation. Minor differences in appearance do not prevent goods otherwise conforming to this definition

manufactured locally. Where an TNC would otherwise import the input, there are obvious trade restricting and distorting effects. Limitations on imports are generally quota based. Foreign exchange controls constrain investors in terms of the amount of intermediate inputs which can be imported. In practice they act like an import quota and can be clearly linked to trade flows. Local equity participation specifies that some proportion of equity must be sourced locally. Like local hiring targets, expatriate quotas and national participation, it is a very common precondition for investment and is designed to indigenise part of the operations of the affiliate.[50]

Local hiring targets, expatriate quotas and national participation in management ensure that specified employment targets are obtained. The trade effects of the above measures, including local equity participation, are not obvious. Where they result in the decision-making process being shifted away from purely commercial criteria, the balance between locally-produced and traded products will be altered. Research development requirements commit TNCs to investment in research and development. Technology transfer commits TNCs to local use of specified technology. Both research and development and technology transfer requirements distort the type of investment undertaken and the firms' commitment to technology transfer. They will impact directly on the composition of the capital stock and its upgrading through time as the foreign firms may be locked into a given research and development commitment, or a certain type of technology which would not otherwise be chosen. They may therefore reduce import requirements and/or limit opportunities for export. Earnings remittance limits restrict the amount of profit which can be repatriated. This can result in a diversion of earnings into investment for local production.[51]

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from being regarded as identical. Similar goods are those goods, which although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and can be commercially interchangeable. Factors to be considered in determining whether goods are similar are the quality of the goods, their reputation and the existence of a trademark. Goods will not be regarded as "identical" or "similar goods" unless they are produced in the same country as the goods being valued.

50 Greenaway, op cit note 46 at 370.

51 Greenaway, op cit note 50. See also Greenaway, op cit note 36 at 141.

7.3.1.2 Output TRIMs

Output TRIMs include export performance requirements, trade balancing requirements, export controls, market reserve policy, product mandating, licensing requirements and technology transfer. Minimum export requirements are the most widely used form of output intervention. Here, host governments specify that a certain proportion of output must be exported or that a certain value of exports be met. Where intervention by host governments is effective, there can be serious trade effects. Because exports would be higher than normal, trade may be deflected from traditional trading partners. Trade balancing requirements act in a similar way by compelling the investors to export more of their output than they would do otherwise. Export controls are a less common form of intervention which specify that certain products may not be exported. Market reserve policy states that the local market is reserved for local producers, who may be actual or potential producers of competing products. Market reserve policy is common in less-developed countries where TNCs are confined to investment in export processing zones. Where foreign investors are locked into the role of exporting, rather than supplying the domestic market, there are clear trade effects. Product mandating requirements force the investor to export the mandated product from the host country only. Depending on the global level of demand and the parent company's global strategy, this requirement could lock the TNC into exports from a higher cost location. Licensing requirements oblige the investor to license production or output in the host country. This could limit the amount of royalties received by the firm and restrain what can be imported from the parent company. Technology transfer, which commits TNCs to local use of specified technology, operates on outputs as well as on inputs.[52]

While there appears to be a wide variety of TRIMs, the use of these interventions varies considerably, with local content requirements and minimum export requirements being the most widely used. These measures have obvious and direct trade distorting effects. The trade effects of other measures, such as local equity participation and local hiring targets, are far less clear. Input-based TRIMs are more prevalent than output-based measures. This is seen as a reflection of the kind of objectives which host governments seek to achieve through the presence of TNCs, mainly employment promotion and

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52 Greenaway, op cit note 46 at 370-371. See also Greenaway, op cit note 36 at 142.

technology transfer. This emphasises the fact that TRIMs are generally investment measures rather than border measures,[53] given that they are imposed at the time of investment.[54]

In addition to the trade-distorting effects of TRIMs, there are also several other characteristics of TRIMs worth noting. These measures, by their inherent nature, leave room for their arbitrary application. Restrictions can be imposed on or negotiated with potential entrants in a secretive, non-transparent fashion that leads to discrimination across firms, uncertainty about future changes in requirements and incentives, rent seeking, and other costly outcomes that decrease any benefits from TRIMs and discourage efficient entry and operations. TRIMs may also be applied in a discriminatory manner between domestic firms and foreign investors. For protective purposes, governments often do not provide national treatment in or equal access to their investment measures. Another distinctive characteristic of TRIMs is that, more than for other commercial policy interventions, performance requirements and fiscal incentives are often provided for at sub-national jurisdictions, for example USA and Canadian provinces. This has led to concerns over the ability of these Federal governments to ensure that investment policies are consistently applied, transparent and non-discriminatory. It also leaves room for non-economic competition for foreign investment on the strength of sub-national interest. These disturbing characteristics of TRIMs suggest that a narrow focus on the trade distortions caused by TRIMs is misleading in welfare terms. The potential for structural damages to the trading system itself, including discrimination, uncertainty, rent seeking and loss of policy control is very real.[55] Despite the trade-distorting effects of TRIMs, there remains a division between those countries who sought the inclusion of investment measures in the GATT and those proposing the exclusion of these measures from the multilateral trade arena.

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53 Loc cit.

54 The distinction between investment measures and border measures is a very important one, as the North-South divide on investment measures rests on this distinction. Put more simply, investment measures are those national policies aimed primarily at investment which tend to reduce global efficiency through sub-optimal allocation of resources in production and rent seeking activities. These measures have an indirect effect on trade. Border measures would be those investment measures clearly designed to influence trade volumes or trade patterns. The distortion of trade is the primary intention of these measures. In this case, the TRIM itself, not its effects, is subject to GATT prohibition. This distinction is important because GATT applies only to border measures, not investment measures. See Maskus and Eby, op cit note 34 at 528-531.

55 Maskus and Eby, op cit at note 34 at 529-30.

7.3.2 TRIMs - economic effects

The issue of investment measures became a real fighting matter for developing countries prior to the failed Seattle Round. Developing countries were particularly concerned about future investment measures being modelled on the now defunct Multilateral Agreement on Investment (MAI), an OECD initiative for deeper integration of investment measures into the trade framework of developed countries. This would have been done by providing transparent and stable rules designed to promote and sustain the liberalisation of foreign direct investment flows.[56] In the discussion relating to a true multilateral framework for investment, Ricupero, the UNCTAD Secretary-General, stated that the key issue in a multilateral framework for investment is flexibility, or creating an autonomous space for policy matters outside the rigid frame of internationally agreed disciplines. He stated that the appeal for flexibility or room for policy manoeuvre is not restricted to developing countries and that it is this issue which doomed the discussions on a Multilateral Agreement on Investment. Ricupero stated further that the developing countries seek to obtain two basic outcomes from an international investment agreement.[57] Rather than mergers and acquisitions which can lead to asset-stripping and mass unemployment, developing countries seek green field investment which generates access to technology, finance management, skills and markets. They also expect to obtain a degree of sanctioned flexibility in dealing with FDI, as FDI is a complex phenomenon and it is impossible to foresee what policies will be needed to deal with its consequences. He concluded by stating that so far there is no empirical evidence to suggest that developing countries are not necessarily better off in terms of attracting and retaining quality FDI within the confines of multilaterally agreed disciplines in investment. It is evident, however, that the existence of investment rules will do little to tackle the problem of distribution of the potential gains from trade and FDI. Investment tends to be concentrated where capital is already present. Imbalances between and within countries, which have sharply increased as a result of globalisation and liberalisation, will therefore not be affected by the absence

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56 OECD (1996:11). See this article for more detail on the Multilateral Agreement on Investment.

57 Khor, op cit note 40.

of investment barriers.[58]

An issue central to the investment debate is whether investment regimes actually alter the allocation of resources in production and trade or merely the distribution of rents of firms and host countries. McCulloch[59] sought to answer this question by dividing direct investments into three categories. She began her analysis, however, by considering the role of direct investments in global production and trade, first in a fully integrated global economy without national boundaries and then in a world divided into sovereign nations.[60]

The categories of cost-driven and policy-driven investments correspond roughly to the rent extraction and resource reallocation objectives of national policy measures. In cost-driven investments, firm location decisions remain the same as in the case of the integrated world economy. The imposition of national boundaries brings potential competition with other tax jurisdictions and foreign owners and workers, for whatever rents are associated with the firm-specific advantage. The main policy tools used to extract rents on behalf of the host government are taxes and rules on transfer pricing and remittance. While taxes have little or no direct effect on production and trade, rents may also be extracted implicitly through binding performance requirements that reduce firm profits. With policy-driven investments, rent extraction is the primary goal of policy makers. This is achieved together with changes in global production that are also policy induced. As most changes in production move a firm away from its profit-maximising position, only marginal results can be expected if policy measures to enhance firm rents are excluded. As long as investments are cost-driven and policies shift rents without affecting the allocation of resources, there is little resulting impact on trade or on the overall economic efficiency. Whether this is true of any particular situation depends on both the host country policies and the underlying economic forces. As a result, less-developed countries have argued that

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58 Khor, op cit note 57. Parties here are referring to an investment agreement which goes beyond the penalisation of trade-distorting investment measures, as included in the TRIMs Agreement. While the GATT 1994 included investment measures, as found in the TRIMs, and GATT Agreements, parties did not go as far as adopting a proper investment agreement. The issues raised here are pertinent to the issue of whether GATT is the proper forum for investment measures.

59 McCulloch, op cit note 42 at 548-52.

60 McCulloch, op cit note 42 at 548.

the GATT should not focus on the measures themselves, but rather on their effects on trade flows, and then only if the resulting trade impact is significant and the resulting injury to other countries is sufficiently great to merit a sacrifice of national sovereignty by the host. The USA, on the other hand, sought an approach which began by identifying particular measures that may be expected to affect trade.[61]

McCulloch's opinion is that in either case, if significant trade effects are the criteria for including investment measures in international negotiations, a large set of policies, including most taxes and many types of incentives will be entirely omitted from consideration. Given the interrelationship between TRIMs and incentives, however, this is not really a problem because the elimination of TRIMs will make incentives redundant. McCulloch concludes that, in practice, national policies aimed at investment tend to reduce global efficiency through the sub-optimal allocation of resources in production and associated rent seeking activities. This is the same as for policies aimed at trade. An important difference is that investment measures are less likely than those aimed directly at trade flows to reduce a country's own aggregate welfare. Where a country is small enough to have no appreciable effect on world prices, the cost of tariff protection is carried almost entirely by the country itself. The net effect of protection on the national welfare of large countries is generally negative as well. When a tariff creates an incentive for import-substituting direct investment, and investment policies are then used to extract some part of the rents generated by foreign-controlled production for the local market, the country could actually gain. The foreign investor will also gain, or expect to gain, in the situation of protection but no investment. The corresponding losses, although larger in the aggregate, will be spread among other competing suppliers but may be small for any one of them. This implies that the problem of TRIMs is at least in part a problem of incomplete liberalisation of trade. Without tariffs, quotas, and other import barriers, there would be less scope for performance requirements.[62]

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61 McCulloch, op cit note 42 at 550-551.

62 McCulloch, op cit note 42 at 551.

The theory of TRIMs as second-best measures is supported by Greenaway[63] and Ariff.[64] Ariff is also of the opinion that the dismantling of trade barriers will make TRIMs redundant, stating that to the extent that trade and factor movements are substitutes for each other, barriers to one will stimulate the other. Barriers to trade will therefore lead to increased foreign investment. The danger here is that a substantial inflow of foreign investment may prompt host countries to impose restrictions which have adverse welfare implications. This is what has been happening. On this reasoning, it appears that the TRIMs issue relates to the symptoms rather than the disease. By implication, parties should be concerned with eliminating trade barriers rather than dismantling TRIMs. While TRIMs both restrict and encourage foreign investment, in either case the measures are trade distorting. Ariff argues that what makes domestic market orientation an attractive proposition to foreign investors is largely the protectionist regime in host countries.[65]

If significant trade liberalisation occurs in the host country, there is little incentive for foreigners to compete for domestic market-oriented manufacturing activities. In this situation, import substitution will be relatively less profitable and, hence, market-discriminating TRIMs will eventually become a non-issue. Regulations which require certain minimum local content will likewise have less appeal under a liberal-trade regime. Local-content programmes can, generally, only be sustained behind protectionist walls. Outward-looking industrial strategies adopted by some developing countries have resulted in authorities having to relax local-content requirements. In many developing countries, imported inputs used in export manufacturing are allowed duty-free access to increase the competitiveness of those products on the international markets. If substantial trade liberalisation were to occur in these countries, the local-content requirements would have to make way for efficiency

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63 Greenaway, op cit note 46 at 376-383. Greenaway states that eliminating import protection and not introducing the content requirement or export requirement would be the first best solution. In a second best situation where pre-existing interventions are regarded as constraints, the introduction of certain TRIMs can possibly be viewed as welfare improving by the host government. He concludes by stating that the economic analysis of TRIMs is extremely complicated, largely because they are by their very nature, second best instruments of intervention. As a result, beyond the point that the optimal policy is the elimination of all investment incentives and all TRIMs, general rules are hard to find.

64 Ariff, op cit note 17 at 347-360.

65 Ariff, op cit note 17 at 352-353.

considerations. By extending the same line of reasoning to export incentives, Ariff concluded that export subsidies, implicit in the export-incentive system, would become unnecessary due to trade liberalisation. Export activities in many countries are disadvantaged by protectionist barriers which have a strong anti-export bias. Tariff and non-tariff barriers that were designed for import-substitution remain even after countries shifted to more outward-looking export promotion.[66]

The dilemma is resolved by offering export incentives which aim to offset or neutralise the built-in bias against exports. Export incentives in such cases may not amount to export subsidies. Ariff concludes that the elimination of protection may obviate the need for export incentives in the final analysis. It is therefore conceivable that export-incentive investment measures will become redundant once trade liberalisation takes place. There is very little economic justification in the belief that distortions caused by protectionist policies can be neutralised by counter-distortions in the form of incentives. The best solution will therefore be to eliminate distortions at the source through trade liberalisation.[67]

Many developing economies see foreign direct investment as the most important means of developing their economies, as TNCs bring with them much needed capital and technological knowledge. Developing countries, as mainly capital-importing countries, have resisted any efforts to reduce control of FDI for two primary reasons. They fear that less regulation carries risks of substantial losses of sovereignty and a surrender of economic control to foreign interests, which may be too high a price for any apparent growth benefits. They also believe that a free market for investment and trade will yield sub-optimal levels of technology transfer and a sustained condition of lagging economic development.[68]

While economic theory points to the benefits of greater trade liberalisation and the dismantling of TRIMs, it is obvious that developed and developing countries are operating at different levels. The

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66 Ariff, op cit note 17 at 353.

67 Loc cit.

68 Maskus and Eby, op cit note 32 at 525.

domestic economies and bargaining power of developed countries are strong enough and sufficient to withstand the further liberalisation of trade. These countries possess the necessary internal regulations and infrastructure to maintain their sovereign rights and have sufficient bargaining power to ensure that they do not have to concede ground in the global arena without extracting an equal concession from bargaining partners. Because their domestic markets are well-developed, further liberalisation of trade will not hinder economic development or the transfer of technology to these economies. With developing countries, the issues are different. Governments are still concerned with the eradication of poverty and illiteracy. Massive developing country debt and the lack of capital has greatly weakened the bargaining power of these countries. Lack of adequate economic policies and trade regulations, together with the lack of necessary infrastructure to back government administrative and regulatory policies does suggest that the sovereignty of these states can be easily compromised.

7.4 TRIMs and the GATT

While many GATT articles can be linked to TRIMs, the most directly affected are Articles III, XI and XVI. These will be briefly discussed below.

7.4.1 Article III: national treatment

The national treatment provision seeks to ensure that foreign goods are not discriminated against upon entry into a host country market. Such products are to be treated in the same way as like products originating within the host state.[69] Article III(4) applies to local content requirements, trade balancing requirements and manufacturing requirements.[70] The first case on investment measures was examined under Article III(4). The 1984 Panel Report on *Canada- Administration of the Foreign Investment*

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69 Article III(4), GATT 1947, WTO (1995:123). Treatment of foreign goods refers to all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

70 Morrissey and Rai, op cit note 16 at 712. With local content requirements a foreign investor is committed to purchasing inputs from domestic manufacturers. Where like inputs of foreign origin are available for sale in the host market, the foreign producer is prevented from purchasing this product. As local content requirements affect the internal sale of imported products, they violate Article III (4).

Review Act[71] examined written purchase and export undertakings under the Foreign Investment Review Act of Canada which were submitted by investors regarding the conduct of the business they wished to acquire or establish, conditional on the approval by the Canadian government of the proposed acquisition or establishment. If the investments were allowed, written undertakings were legally binding on the investors. The Panel first sought to determine whether the undertakings could be considered "laws, regulations or requirements" within the meaning of Article III(4).

With respect to requirements applied in individual cases, the Panel did not accept the Canadian view that the word "requirements" in Article III(4) should be interpreted as "mandatory rules across-the-board" because this latter concept was already more aptly covered by the term "regulations" and the author must have had something different in mind when adding the word "requirements".[72] The Panel felt that the fact that four disputes which had been brought before the Contracting Parties regarding the application of Article III(4) had concerned only laws and regulations did not justify an assimilation of "requirements" with "regulations". The Panel also considered whether, when judging if a measure is contrary to obligations under Article III(4), it is not relevant whether it applies across-the-board or only in isolated cases. The Panel concluded that any interpretation which would exclude case-by-case action would defeat the purposes of Article III(4).[73] The Canadian view that the purchase undertakings should be considered as private contractual obligations of particular foreign investors *vis-a-vis* the Canadian government was also examined. The Panel felt that private contractual obligations entered into by investors should not adversely affect the rights which contracting parties, including those not involved in the dispute, possess under Article III(4) of the General Agreement and which they can exercise on behalf of their exporters. This applies particularly to the rights deriving from the national treatment principle, which - as stated in Article III(1) - is aimed at preventing the use of internal measures which provide protection to domestic production.[74]

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71 L/5504 (4), adopted 7 February 1984, 305/140, 159-161, paragraphs 5.7-5.11.

72 L/5504(4), adopted 7 February 1984, 305/140, 159, paragraph 5.5

73 L/5504(4), op cit note 72.

74 L/5504, adopted on 7 February 1984, 305/140, 159, paragraphs 5.5-5.6, WTO, op cit note 69 at 173.

On the issue of requirements associated with the regulation of international investment, the Panel examined the Canadian argument that in accordance with Article XXIX:1 of GATT 1947,[75] the word "requirements" in Article III(4) of the GATT should be interpreted in the light of Article 12 of the Havana Charter concerning the right to regulate foreign investment. On this issue the Panel stated that it could be assumed that the drafters of Article III had intended the term "requirements" to exclude requirements connected with the regulation of international investments. It could not find anything in the negotiating history, the wording, the objectives and the subsequent application of Article III which would support such an interpretation.[76]

The Panel then examined the question of whether less favourable treatment was accorded to imported products than to like products of Canadian origin in respect of requirements affecting their purchase. In this respect the Panel distinguished between undertakings to purchase goods of Canadian origin and undertakings to use Canadian sources of supplies, irrespective of the origin of the goods. For both types of undertakings the Panel took into account the qualifications "available", "reasonably available" or "competitively available". The Panel found that the undertaking to purchase goods of Canadian origin without any qualification excludes the possibility of purchasing available imported products so that the latter are clearly treated less favourably than domestic products. Such requirements are therefore not consistent with Article III(4). This finding is not modified in cases where undertakings to purchase goods of Canadian origin are subject to the qualification that such goods be "available". Where Canadian goods are not available, the question of less favourable treatment of imported goods is not an issue.[77]

When the undertakings are conditional on goods being "competitively available", the choice between Canadian and imported products may frequently coincide with normal commercial considerations. The

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75 Article XXIX deals with the relation of the GATT 1947 to the Havana Charter. Article XXIX(1) states that "the contracting parties undertake to observe to the fullest extent of their executive authority the general principles of Chapters I to VI inclusive and of Chapter IX of the Havana Charter pending their acceptance of it in accordance with their constitutional procedures." (WTO, op cit note 49 at 530).

76 L/5504, adopted on 7 February 1984, 305/140, paragraph 5.12, WTO, op cit note 69 at 174.

77 L/5504, adopted on 7 February 1984, 305/104, paragraphs 5.7-5.8. WTO, op cit note 76.

imported goods will not be adversely affected whenever one or the other is more competitive. It was the Panel's understanding that the term "competitively available" referred to situations where Canadian goods were available on competitive terms. The Panel considered that in those cases where the imported and domestic product were offered on equal terms, the undertaking would ensure that preference was given to the domestic product. The purpose of Article III(4) is not to protect the interests of the foreign investor but to ensure that goods originating in any other contracting party benefit from treatment no less favourable than domestic goods, in respect of the requirements affecting the purchase. Based on these considerations, the Panel found that the requirement to purchase Canadian goods, also when subject to "competitive availability", was contrary to Article III(4). The Panel also found the qualification "reasonably available" to be inconsistent with Article III(4), since the undertaking implies that preference has to be given to Canadian goods when they were not available on entirely competitive terms.[78]

On the issue of the undertakings to buy from Canadian suppliers, the Panel did not consider the situation where domestic products were unavailable, since such a situation is not covered by Article III(4). The Panel understood the choice under this type of requirement to apply to imported goods if bought through a Canadian agent or importer. It also applied to Canadian goods which could be purchased either from a Canadian middleman or directly from the Canadian producer. The Panel recognised that these requirements might have little or no effect on the choice between imported or domestic products in a number of cases. The possibility of purchasing imported goods direct from the foreign producer is excluded. As the conditions for purchasing imported products through a Canadian agent or importer would normally be less advantageous, the imported product would have more difficultly in competing with Canadian products and be treated less favourably. For this reason, the Panel found the requirements to buy from Canadian suppliers inconsistent with Article III(4).[79] In conclusion the Panel sympathised with the Canadian authority's desire to ensure that Canadian goods and suppliers would be given a fair chance to compete with imported products. It was the Panel's view that the purchase requirements under examination did not stop short of this objective but tended to tip

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78 L/5504, adopted 7 February 1984, 305/140, 159-161, paragraphs 5.7-5.11 WTO, op cit note 69 at 165.

79 WTO, op cit note 78.

the balance in favour of Canadian products, and were therefore in conflict with Article III(4).

The Panel did not consider the extent to which purchase undertakings reflected the plans of investors nor did it feel competent to judge how the foreign investors were affected by the purchase requirements, as the national treatment obligations of Article III do not apply to foreign persons or firms, but to imported products, and serve to protect the interests of producers and exporters established on the territory of any contracting party. Purchase requirements applied to foreign investors in Canada which are inconsistent with Article III(4) can affect the trade interests of all contracting parties, and impinge on their rights.[80]

Trade balancing requirements violate Article III(4) if they limit the number of imported products that can be used, resulting in an TNC not meeting its export targets. Where a manufacturing requirement means that a foreign investor is no longer in a position to use imports and is obliged to produce the input itself locally, the national treatment principle is violated. Article III(5) states that "no contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources." Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.[81]

This provision prohibits local content requirements altogether. The national treatment requirements relate to measures that result in imports being discriminated against. The product should therefore actually be present in the host country. This point is important as it distinguishes those TRIMs that cause internal discrimination (when the goods are present) from those measures that affect importation but do not cause internal discrimination. As a result, only local content requirements are illegal *per*

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80 L/5504, adopted 7 February 1984, 305/166-167, paragraphs 6.3, 6. WTO, op cit note 69 at 166.

81 Article III(1) provides that the contracting parties recognise that internal taxes or other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to protect domestic production (WTO, op cit note 49 at 490).

se. The other requirements violate the national treatment principle, but depend on the imports actually being present within the domestic market. Where imported goods are not present, national treatment cannot be violated because there is nothing to discriminate against. The focus will then be on requirements affecting importation, for example, Article XI.[82]

7.4.2 Article XI: Elimination of quantitative restrictions

Article XI(1) provides that "no prohibitions or restrictions other than duties, taxes and other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product from the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party".[83] The gist of Article XI (1) is that it prohibits non-tariff barriers. There are exceptions to this provision, however. Article XII(1) permits states to restrict the quantity or value of merchandise permitted to be imported, where this will safeguard their external financial position or their balance of payments position.[84] Developing countries may use import and export restrictions where this is necessary to protect an infant industry.[85] Article XI(1) is violated by any non-tariff measures which distort imports. A TRIM which restricts imports violates Article XI(1). Article XI(1) also deals with measures that effect the exportation of goods from the territory. In theory this applies to measures which both decrease and increase the level of exports. In practice, however, only those measures which attempt to restrict exports quantitiveley are affected.[86]

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82 Morrissey and Rai, op cit note 16 at 712 to 713.

83 WTO, op cit note 49 at 500.

84 WTO, op cit note 49 at 501.

85 Article XVIII (2)(a) and (b), WTO, op cit note 49 at 511.

86 Morrissey and Rai, op cit note 16 at 713.

In the 1950 report of the Working Party on "*The Use of Quantitative Restrictions for Protective and Commercial Purposes*",[87] several types of export restrictions which are applied for protective, promotional or other commercial purposes were examined. The Working Party found four categories of export restrictions which fall outside the exceptions provided for in Articles XI, XIII, XIV, XV and XX. These are:[88]

a) export restrictions used by a contracting party to coerce another contracting party to relax its import restrictions;
b) export restrictions used by a contracting party to coerce another contracting party to relax export restrictions on commodities in local or general short supply, or otherwise to obtain an advantage in the procurement from another contracting party of such commodities;
c) restrictions used by a contracting party on the export of raw materials, where they protect or promote a domestic fabricating industry;
d) export restrictions used by a contracting party to avoid price competition among exporters.

Trade balancing and domestic sales requirements are generally seen to be in violation of Article XI(1). Trade balancing requirements, by limiting the number of imported products that can be used, could result in artificial restrictions on imports, thereby protecting domestic firms. These requirements are therefore in violation of Article XI(1).[89] While Article XI(1) does not apply to export performance requirements if they seek to establish minimum export levels, domestic sales requirements are deemed to fall within the ambit of this article as they act as an export ceiling. By diverting some of a firm's output from export markets to home markets, this requirement effectively limits the firms' level of

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87 GATT/CP.4/33, republished as "The Use of Quantitative Restrictions for Protective and Commercial Purposes," Sales No GATT/1950-3 (WTO, op cit note 69 at 325).

88 WTO, op cit note 87, paragraph 2.

89 Maskus and Eby, op cit note 34 at 531.

exports.[90] For this argument to hold, however, it must be shown that the export restriction is meant to avoid competition amongst exporters.

7.4.3 Article XVI: subsidies

Export performance requirements may fall within the ambit of GATT rules on subsidies. When investment incentives and export performance requirements are used together, they are seen to operate as indirect subsidies. Exports are deemed to be subsidised if the firm is given money to export. An investment incentive has the same effect as giving money. Export performance requirements used together with investment incentives are indirect export subsidies. Investment incentives do not attract any GATT discipline. Neither do export performance requirements. Where export performance requirements together with investment incentives result in an increase in exports, Article XVI applies. The provisions most likely to be affected are Articles XVI(3) and (4). Article XVI (3) provides that contracting parties should attempt to avoid using subsidies on the export of primary products. Where a contracting party directly or indirectly grants a subsidy which operates to increase exports of primary products from its territory, this subsidy must not be applied in a manner which results in the relevant state gaining more than an equitable share of the world export trade in that product.[91]

Article XVI (4) prevents contracting parties from directly or indirectly granting any subsidy on the export of any product other than a primary product where the subsidy results in the sale of the product being exported at a price lower than the comparable price charged for the like product in the domestic market.[92] In combination with fiscal incentives, minimum export requirements can be construed as indirect export subsidies on non-primary products, which are banned by Article XVI(4) if they result in lower export prices than domestic market prices. They many also be in conflict with Article XVI(3) on primary products if they result in more than an equitable share of world export trade. The fiscal incentives provide firms with the means to meet the export requirements, resulting in a *de facto* export

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90 Morrissey and Rai, op cit note 86.

91 WTO, op cit note 49 at 509.

92 Loc cit.

subsidy. The same argument can be applied to trade-balancing requirements with incentives if the firms choose to export more than optimal amounts in order to increase their imports.[93]

7.5 Agreement on Trade-Related Investment Measures (TRIMs)

The Agreement on Trade-Related Investment Measures is not a complete agreement on investment but refers mainly to trade-related investment measures which have been deemed incompatible with the relevant GATT provisions. Article 2(1) of the TRIMs Agreement provides that no Member state shall apply any TRIM which is inconsistent with the provisions of Article III or Article XI of GATT 1994.[94] The Annex to the TRIMs Agreement contains a list of TRIMs deemed inconsistent with the GATT. TRIMs which are inconsistent with Article III(4) of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or with which it is necessary to comply to obtain an advantage and which require:[95]

a) the purchase or use by an enterprise of products of domestic origin or source, whether specified in terms of particular products, volume or value of products or in terms of a proportion of volume or value of its local production; or

b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

Annex 1 (a) refers to local content requirements which require that a certain percentage value of inputs be obtained within the host country territory. Annex 1(b) refers to trade balancing requirements which oblige an investor to offset imports of materials with an equal value of product exports.[96]

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93 Morrissey and Rai, op cit note 86; and Maskus and Eby, op cit note 34 at 532.

94 These are the national treatment and quantitative restriction provisions (WTO, op cit note 49 at 163).

95 Annex 1, WTO, op cit note 49 at 162-163.

96 Burt, op cit note 2 at 1036.

Annex 2 refers to TRIMs which are inconsistent with Article XI(1) of GATT 1994 including those which are mandatory or enforceable under domestic law or under administrative rulings, or with which compliance is necessary to obtain an advantage, and which restrict:[97]

a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;
b) the importation by an enterprise of products used in or related to its local production by restricting its foreign exchange access to an amount related to the foreign exchange inflows attributable to the enterprise; or
c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, volume or value of products or in terms of a proportion of volume or value of its local production.

The investment measures which violate GATT's prohibition of quantitative restrictions include general import restrictions and trade balancing restrictions, foreign exchange balancing restrictions on imports and domestic sales requirements. The Annex 2(a) prohibition of restrictions "on the importation by an enterprise of products used in or related to its local production, generally" refers to general import restrictions. The Annex 2(a) restriction on "the importation by an enterprise of products used in or related to its local production to an amount related to the volume or value of local production that its exports" refers to trade balancing restrictions. Annex 2(b) refers to foreign exchange balancing restrictions on imports while Annex 2(c) refers to domestic sales requirements.[98]

All exceptions under GATT 1994 apply, where appropriate, to the provisions of the Agreement.[99] Members have reaffirmed their commitment to obligations of transparency and notification in Article

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97 WTO, op cit note 49 at 167.

98 Burt, op cit note 96.

99 Article 3, WTO, op cit note 49 at 1614.

X of GATT 1994.[100] Members must notify the Secretariat of the publications in which TRIMs may be found, including those applied by regional and local governments and authorities within their territories.[101] Member states have also agreed to give sympathetic consideration to requests for information, and provide adequate opportunity for consultation on any matter arising from the Agreement raised by another Member. In accordance with Article X(1) no Member is required to disclose information where this disclosure will impede law enforcement or is otherwise contrary to public interest or will prejudice the legitimate commercial interests of particular enterprises, public or private.[102]

The Agreement has made provision for the special treatment of developing countries. Article 4 provides that developing country Member states can deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994,[103] the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 permit the Member states to deviate from Articles III and XI of GATT 1994. Article VIII(2)[104] recognises that it may be necessary for contracting parties seeking to implement programmes and policies of economic development designed to raise the general standard of living of their people to take protective or other measures affecting imports. These measures are justified in so far as they facilitate the attainment of the Agreement. The affected contracting parties enjoy additional facilities which enable them to maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry.[105] They may also apply quantitative restrictions for balance of payments

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100 Article 6(1)WTO, op cit note 49 at 165. Article X refers to the publication and administration of trade regulations. For an in depth look at this provision, see WTO, op cit note 69 at 498-499.

101 Article 6(2) WTO, op cit note 100 at 165.

102 Article 6(3), WTO, op cit note 100 at 165.

103 This Article refers to governmental assistance for economic development.

104 WTO, op cit note 49 at 511. Article XVIII(1) states that the attainment of the objectives of this Agreement will be facilitated by the progressive development of their economies, particularly of those contracting parties whose economies can only support low standards of living and are in the early stages of development.

105 Article XVIII(2)(a), WTO, op cit note 104 at 511.

purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development.[106]

A contracting party whose economy can only support low standards of living and is in the early stages of development (less-developed economy) is free to deviate temporarily from the other Articles of the Agreement, as provided for in Sections A, B, and C of Article XVIII.[107] Section A states that where a less-developed country considers it necessary to modify or withdraw a concession included in the appropriate schedule annexed to the Agreement, in order to raise the general standard of living of its people, or promote a particular industry, it must notify the Contracting Parties of this and enter into negotiations with any contracting party with which the concession was initially negotiated.[108] Section B deals with balance of payments difficulties which may be experienced by less-developed economies in the face of rapid economic development. Where it is necessary to safeguard its external financial position and ensure a level of reserves adequate for the implementation of its programme of economic development, a less-developed economy may control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported. The import restrictions instituted, maintained or intensified must not exceed those necessary to forestall the threat of, or stop, a serious decline on its monetary reserves or achieve a reasonable rate in the increase of its reserves where there are inadequate monetary reserves.[109]

Section C provides for the situation where governmental assistance is required to promote the establishment of a particular industry but no measure consistent with the other provisions of the Agreement is practicable to achieve the objectives.[110] In this case, if the industry receiving assistance has already started production, the contracting party may, after informing the Contracting Parties, take such measures as may be necessary to prevent, during that period, imports of the product or products

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106 Article XVIII(2)(b), WTO, op cit note 104 at 511.

107 Article XVIII(4)(a), WTO, op cit note 104 at 511.

108 Article XVIII(7)(a), Section A, WTO, op cit note 49 at 512.

109 Article XVIII(9)(a) and (b), Section B, WTO, op cit note 108 at 512.

110 Article XVIII(13), WTO, op cit note 49 at 515.

concerned from increasing substantially above the normal level.[111] Section D refers to normal developing countries.[112] Where a developing country seeks to introduce a measure of the type described in Article XVIII(13) in respect of the establishment of a particular industry, it may apply to the Contracting Parties for approval of the measure. Such measures must, however, be sought in the interest of the development of its economy.[113]

Developing country members had to eliminate all TRIMs notified under paragraph 1 within five years of the date of entry into force of the WTO Agreement. Least-developed countries had seven years in which to eliminate all relevant TRIMs.[114] Notwithstanding the provisions of Article 2, a Member could during the transition period apply the same TRIM to a new investment where the products of such an investment are like products to those of the established enterprises and where it was necessary to avoid distorting the conditions of competition between the new investment and the established enterprises. This was done in order not to disadvantage established enterprises which were subject to a TRIM notified under paragraph 1. Any TRIM applied to a new investment had to be notified to the Council for Trade in Goods. The terms of such a TRIM had to be equivalent in its competitive effect to those applicable to the established enterprises and had to be terminated at the same time.[115]

From the above provisions, it is evident that developing countries receive slightly more favourable treatment than developed countries under the TRIMs Agreement, despite the fact that TRIMs prohibitions apply to all members after the phase-in periods have expired. Article XVIII makes allowance for the economic and developmental needs of least-developed economies, enabling these countries to maintain flexibility in their economic policies. In their argument against the inclusion of all TRIMs in the GATT, *ie* the adoption of a broad approach, the developing countries had argued that the GATT should consider an agreement subjecting trade-distorting restrictive business practices to

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111 Article XVIII(14), WTO, op cit note 110 at 515.

112 See Article XVIII(4)(b), WTO, op cit note 110 at 515.

113 Article XVIII (22) WTO, op cit note 49 at 517.

114 Article 5(2), WTO, op cit note 49 at 164.

115 Article 5(5), WTO, op cit note 49 at 165.

GATT principles. They also emphasised the importance of investment measures in channelling FDI to national development objectives and sought to limit the examination of TRIMs to those measures with direct and significantly adverse trade affects.[116]

The developing countries succeeded in limiting the TRIMs Agreement to measures with direct and adverse trade effects. The scope of measures falling under the TRIMs Agreement has as a result been limited. The TRIMs Agreement's prohibition of several common investment measures[117] has constrained a developing country's ability to apply direct trade distorting TRIMs. This, according to the developing economies, constrains their ability to deal adequately with TNCs. The developing countries have argued that the TRIMs Agreement is deficient because it ignores the underlying causes for the imposition of TRIMs while focusing only on the outcomes of the investment measures.[118] It is certainly true that the TRIMs Agreement does not focus on the reasons for the implementation of TRIMs but seeks instead to prohibit those measures which themselves are directly trade-distorting. Restrictive business practices are applied by TNCs in both developed and developing economies. The developing countries are more directly affected as they lack the necessary infrastructure to monitor and audit TNCs, thus keeping tighter control on the activities of these enterprises. Because many restrictive business practices affect the balance-of-payments figures of the affected countries in a negative manner, where it can be shown that TNCs are a direct contributing factor, it can perhaps be argued that the provisions of Article XII(1) and (2) of GATT 1994 apply.

As the TRIMs responsible for the restriction of restrictive business practices are also used to achieve investment goals, it would be difficult to distinguish between the use of direct trade- distorting TRIMs for protectionist purposes and the restriction or elimination of restrictive business practices. As both developed and developing countries utilise TRIMs in part to eliminate restrictive business practices, a focus on the reasons for the adoption of TRIMs would raise too many difficult questions. A more important point relates to the ability of the GATT to deal with the causes of TRIMs in the absence of

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116 Burt, op cit note 2 at 1035.

117 Examples being local content requirements, general import restrictions, and trade balancing requirements.

118 Burt, op cit note 2 at 1038.

a proper investment forum and GATT investment agreement. By limiting the GATT provisions to border measures and trade-related investment measures per se, the GATT is only competent to deal with those TRIMs which are directly trade-distorting and are, as such, in conflict with relevant GATT articles. There is therefore no room for a discussion of the origins of TRIMs.

The 1984 Panel Report on "*Japanese Measures on Imports of Leather*"[119] dealt with a similar matter. Referring to arguments made by Japan in justification of quantitative restrictions on imports, the Panel considered that the special historical, cultural and socio-economic circumstances referred to by Japan could not be taken into account in this context since its terms of reference were to examine the matter in the light of relevant GATT provisions, and these provisions did not provide such a justification for import restrictions. A Panel report adopted by the Contracting Parties in 1983, in a similar situation, concluded "that such matters did not come within the purview of Articles XI and XIII of the GATT and lay outside its consideration". The 1988 Panel Report on "*Japan - Restrictions on Imports of Certain Agricultural Products*"[120] noted that regarding the vital role the twelve items under consideration played in Japan's agricultural sector, regional economy and the underlying social and political background. The Panel - while aware of their significance in the Japanese context - found that previous panels had established that such circumstances could not provide a justification for import restrictions under the GATT. Because restrictive business practices are not provided as one of the exceptions to the provisions of Article XI(1), the GATT cannot accept these measures as justification for the application of TRIMs.

The TRIMs Agreement does ensure that the global environment is slightly less protected. The transparency provision ensures that states and enterprises alike are more aware of the investment and trade measures facing them. For the advanced developing economies whose TNCs seek to enter both developed and developing country markets, greater liberalisation and transparency will provide easier access into these markets. The overall ban on selected TRIMs provides developing and least-developed economy governments with the opportunity to adopt and implement more stringent

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119 L/5623, adopted on 15/16 May 1984, 315/94,111, paragraph 44, WTO, op cit note 69 at 732.

120 L/6253, adopted on 2 February 1988, 355/163, paragraph 5.4.1.4, WTO, op cit note 69 at 733.

regulatory procedures for the control or monitoring of TNC behaviour. Greater transparency requirements may foster goodwill between the TNCs and developing country officials while reducing corruption and bribes. While the TRIMs Agreement does not differentiate between developing and developed country TRIMs, Article XI(a) exceptions provide least-developed and developing countries with some flexibility with which to pursue their economic and developmental goals.

7.6 Does the Agreement on TRIMs discriminate unfairly?

The analysis of unfair discrimination will begin with a determination as to whether the Agreement recognises differences amongst states and makes allowances for differences. Within the TRIMs Agreement recognition is given to developing and least-developed economies which are seen as separate groups. All other Member states are seen as similar and subject to the same provisions. Exceptions made for developing countries and less-developed countries apply to all these countries or groups equally. While there is an element of discrimination, countries within each group or category are treated similarly. As similar treatment of those within groups is a requirement for fairness and equal treatment, treatment of groups themselves cannot be seen as being unfairly discriminatory.

While the Agreement on TRIMs is applicable to all Member states, developing economies are given greater leeway than developed states in that they may waive the provisions of this Agreement where it is necessary for the upliftment of their economies, protection of balance-of-payments and the development of infant industries within their economies. Although the general focus of the Agreement on TRIMs is the elimination of government interference in domestic markets, especially where such interference results in increased protection. Article XVIII provides for governmental assistance of domestic industries where this is necessary for economic development. Discrimination, within this context, goes beyond the superficial provision of different times for implementation by Member states. Developing economies are not unduly restricted by the Agreement. Developing countries are however, open to retaliation, where they adopt measures targeting development. Retaliation is very likely in a climate of liberalisation where developing countries are being encouraged to liberalise their economies, in order to obtain better access to developed country markets. While the Agreement permits developing countries to protect their economies where this is necessary to achieve

development objectives, it does not protect developing countries from retaliation by developed economies.

Given that there is discrimination between Member states, it is necessary to determine whether this discrimination amounts to unfair discrimination. To this end it is necessary to determine whether the ability of developing Member states to waive their obligations under the TRIMs Agreement and/or eliminate TRIMs over a longer period amounts to unfair discrimination against developed economies. It will therefore be determined whether there is a rational connection between the discrimination and a legitimate WTO aim. Without the correct infrastructure and with the lack of transparency in developing country processes for implementing TRIMs, it is conceivable that a greater implementation period is necessary to ensure that developing country governments eliminate TRIMs and put into place measures which are consistent with GATT provisions. This is something that Member states are mindful of. In the Preamble to the Agreement on TRIMs, Members agreed to take into account the particular trade development and financial needs of developing country Members, particularly those of the least-developed country Members.[121] Measures which favour developing countries reflect this undertaking by states. A greater period for eliminating TRIMs within the developing country context is more likely to ensure effective implementation of the provisions of the TRIMs Agreement in the context of developing economies. Because developing economies are not sources of capital, and generally employ investment generating TRIMs, it is highly unlikely that the longer implementation period will impact negatively on resident TNCs as they are generally well compensated through trade incentives.

The greater flexibility given to developing economies to waive the provisions of the TRIMs Agreement is also a concession to development. Because of the vulnerability of infant industries to competition from TNCs and governments to balance-of-payments difficulties, developing economies have been provided with the ability to protect their economies and industries. While the protection of infant industries may not necessarily be the best way for countries to achieve greater competitiveness on international markets, protection of infant industries which have been fast-tracked for export

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121 WTO, op cit note 49 at 163.

markets, under specific conditions, has been known to succeed.[122] While infant industry protection may not be a first best policy, under competitive conditions, fledgling industries within developing economies may not be able to compete against more established, international industries. Protection of these industries gives them a chance to develop and gain a foothold within domestic markets. Where TNCs operate within domestic host markets, it may be difficult for fledgling domestic industries to obtain significant market share within domestic markets, let alone the international arena. This is a reason why infant industry protection, while not ideal, is permitted within developing markets. The restriction of TNC activities to specific, targeted areas also allows developing country governments to control the amount of foreign exchange leaving its markets, thus controlling its balance of payment margins and consequently the value of its currency. While the options open to developing economies may be second best instruments, they are directly linked to their developmental goals. Discrimination within this context is therefore permissible, as a rational connection can be made between the discrimination and a legitimate WTO goal.

While the discrimination may fulfil the requirements of the rational connection test, it must also be proportional, *ie* there must be a relationship of proportionality between the means employed and the aim sought to be achieved. The discrimination permitted is generally inwardly focused, with the developing economies being given longer periods for implementation of the Agreement or being permitted to protect their economies where this will enable them to regulate balance of payments margins or protect infant industries. While developing economies have been recipients of a measure of FDI, only six developing economies have really benefited from extensive FDI inflows. Longer implementation periods for the elimination of TRIMs by other developing economies who are not recipients of extensive FDI inflows are unlikely to impact negatively on resident TNCs. Within the context of developing economies, TRIMs are unlikely to have affected TNCs much because of the trade incentives given to these companies by countries desperate to attract FDI.

In the case of higher tariff protection and reduced access to developing country markets, this is a reality which has faced TNCs for some time because of the extremely high levels of tariff protection

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122 An example is the Korean automobile industry.

which developing countries have placed on imported goods. These high tariff levels have actually attracted FDI to countries as they permit TNCs to reap monopolist profits. Where developing economies are very undeveloped, restriction of TNCs to export processing zones may actually benefit these foreign firms as they are able to enjoy the benefits of cheaper labour and abundant resources while having access to world markets. The restriction of developing country markets in cases of infant industry protection is therefore unlikely to have an unduly negative impact on developed countries and their industries. Discrimination, in this instance, does not place any obligations on the developed economies. The means employed are therefore in keeping with the aim sought to be realised. The discrimination is therefore proportional.

The purpose of the Agreement is to promote the expansion and progressive liberalisation of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners, particular developing country Members, while ensuring free competition.[123] Analysis of TRIMs has shown that TRIMs measures are not the most efficient investment measures and actually constitute second-best policy instruments. Those TRIMs which contravene the national treatment clause and anti-quantitative restriction legislation are themselves discriminatory as they allow states to discriminate between domestic goods and foreign goods, effectively protecting domestic goods. Such behaviour is deemed protectionist as it indicates that Member states are not acting within the spirit of the GATT and the most-favoured-nation principle which requires Member states to treat goods from Member states equally.

The aim of the Agreement, primarily, is the elimination of trade-distorting TRIMs. These are TRIMs which have directly distortive effects on global trade and investment, and allow the state applying these measures to protect its economy against foreign investment and consequently foreign competition. As stated earlier, trade-distorting TRIMs can take the form of subsidies, quantitative restrictions and provisions contrary to the national-treatment provision. The Agreement on TRIMs provides for the elimination of measures contrary to the national treatment provision and quantitative

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123 WTO, op cit note 49 at 163. While the link between liberalisation and growth and development is currently being debated, (see, for example, Rodriguez and Rodrik, 1999; Dollar and Kraay, 2001 a,b) it is an assumption accepted by the GATT Member states and provides the foundation upon which GATT is based.

restrictions. Subsidies, which are the most trade-distorting TRIMs and the most bothersome to developing country exports, have been left out of the Agreement and are dealt with separately under the Agreement on Agriculture and the Agreement on Subsidies and Countervailing Measures. To the extent that the Agreement on TRIMs seeks to eliminate those TRIMs which are contrary to Article III and XI of the GATT 1994, it is successful, as it deals directly with these measures. Regardless of their economic status, all states are to eliminate these measures. The Agreement on TRIMs is exceptional in that it does not impose additional duties on Member states but merely seeks to eliminate those measures which are economically inefficient and contrary to the aims of GATT. The purely economic focus of the Agreement allows for economically efficient outcomes as all states are forced to eliminate trade-distorting TRIMs.

Except for the exceptions given to developing economies, the Agreement does not address the problems faced by developing economies in seeking to attract FDI or control the activities of TNCs within developing markets. As capital is more freely available in developed economies, measures which encourage interaction between developed and developing country governments and allow for information transfer, transfer of technology and legal and policy assistance to developing economies would be a positive step. While requirements for the attraction of FDI are often mentioned by developed country governments, very little assistance has been provided to developing country governments to help them address the particular problems experienced within their respective economies which will help them attract FDI. While developing countries are required to eliminate TRIMs, regardless of the economic effects of these measures, they are not given alternatives. There is instead, the equal treatment of developing and developed economies. Given that most FDI inflows are north-north, as opposed to north-south, the greater emphasis on developed country issues is understandable. While developing country issues are not dealt with in great depth, the gains from liberalisation of markets through decreased TRIMS carries over to developing country markets as well. The formal approach to the application of the provisions of the Agreement cannot therefore be faulted as the economic benefits to developing economies outweighs any losses.

Even though the Agreement on TRIMs appears to be rational, proportional and economically efficient, it is important that it prevents the abuse of power. This is to be done through the reduction or

elimination of power of the more powerful states while addressing inequalities through redress. The Agreement seeks to prevent government intervention in the markets through trade-restrictive investment measures. Nothing is said about TRIMs which are imposed by states to prevent abuse by TNCs through restrictive business practices. While TRIMs affect all states seeking to invest in foreign countries, the majority of countries which are affected are developed states, as are the TNCs which will benefit from less restricted access to developed markets. Discriminatory behaviour in this context may indicate the abuse of power by developed states who are not faced with the need to protect infant industries or ensure against balance-of-payments difficulties. Such behaviour is contrary to the spirit of the GATT which seeks to ensure increased economic growth of developing economies through free and open trade. Liberalised developed markets are essential if developing economies are to stand a chance of competing fairly on the global markets. Benefits from the elimination of TRIMs are not limited to developed country TNCs, however, as the advanced developing economies have also sought entry into developed and other developing markets. TNCs from these countries will therefore benefit as well.

To the extent that developing countries are able to deviate from the Agreement on TRIMs for the establishment of infant industries and the protection of their balance-of-payment positions, they are able to protect their economies from TNCs activities. This, however, is the only concession which the Agreement has made to TRIMs and issues which are of real concern to developing countries. While governments are prevented from applying trade-distorting TRIMs, nothing has really been said about restricting the power which TNCs have in their host states. Although it may be felt that by not dealing with these issues developing country governments are given sufficient leeway to deal with restrictive business measures, many developing economies do not have the resources needed to monitor TNC behaviour, and because they need the capital brought in by foreign investment, may feel powerless to deal with these companies. Recognition of the problems faced by developing country governments and a commitment by parent countries to monitor the behaviour of their TNCs would have been of great benefit to developing country governments.

On the issue of abuse of power, the Agreement on TRIMs reduces the power of developed countries to discriminate against foreign companies and foreign exports. This is an outcome which bodes well

for foreign investors from developed and developing countries. While the Agreement reduces abuse of power by governments, it gives TNCs greater power as it prevents governments from controlling TNC activities through trade-distorting TRIMs. It does not, however, deal with ways of preventing abuse of power by TNCs, although developing economies may close their markets to foreign investment, where necessary. On the issue of greater access to FDI developing economies are still at the mercy of capital rich countries. The Agreement does not make concessions to development by providing for more proactive behaviour by developed country governments to encourage their TNCs to invest in developing economies. Despite these shortcomings of the Agreement, much has been achieved. The elimination of trade distorting investment measures provides for greater liberalisation of global markets and reduced protection of domestic markets, especially in developed economies. The fact the most developing economies are not yet in a position to benefit from these provisions should not diminish the gains achieved by the Agreement. While the power of TNCs is not curtailed by the Agreement, developing economies are not without their remedies however, as the Agreement prevents only trade-distorting TRIMs and does not curtail the ability of states to take the relevant legal and economic steps needed to prevent abuse by TNCs.

7.7 Conclusion

The need to eliminate trade-distorting TRIMs is an important one, as these measures do enable host states to indulge in discriminatory behaviour. Elimination of these measures does not, however, remove the fact, that if unchecked, TNCs can pose a greater threat to their host states, especially developing country hosts, than they can be of benefit. While the Agreement does not address the increasing power of TNCs, it does achieve its goal of regulating and eliminating the use of trade-distorting TRIMs. Although it can be argued that developing country issues have not been adequately addressed, this lapse is forgivable and understandable given that most FDI flows into developed economies. The Agreement reflects this fact and addresses mainly the problems experienced within a developed country context. Despite this limited focus, the Agreement achieves its goal and cannot be deemed discriminatory. To the extent that the Agreement seeks to eliminate trade-related investment issues, it is fair.

Chapter 8

The Agreement on Trade-Related Aspects of Intellectual Property Rights

8.1 Introduction

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is of major concern to developing and developed economies alike because of the extensiveness of the patent provisions. Of great concern to developing economies is Article 27 (3)(b) which permits the patenting of micro-organisms and plant varieties.[1] Developing countries are also of the opinion that the patent provisions are economically inefficient and protectionist. In this chapter, developing country concerns will be documented and the welfare effects of TRIPS analysed. The Agreement on TRIPS, specifically the patent provisions, will be studied in order to determine whether they discriminate unfairly against developing country exports or prevent the development of indigenous industries.

8.2 Developing country concerns

Traditional economic theory on patent protection states that greater patent protection is necessary for greater innovation. Modern economic theory suggests that, contrary to the popular norm, it is increased competition which has spurred greater innovation.[2] Despite evidence of the validity of this conclusion in the business environment,[3] traditional economic theory on patent protection is still widely accepted. Of all the TRIPS Agreement provisions, it is the patent provisions which are of greatest concern to developing countries and of most relevance to the issue of investment measures,

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1 WTO (1995:379).

2 Subramanian (1990:515).

3 With increased global trade and competition outside of national boundaries there has been increased innovation in the fields of technology, science and information technology. This increased innovation cannot be linked to increased patent protection as most of the world's developing countries and some developed economies were guilty of inadequate patent regulations prior to the TRIPS Agreement.

as they are directly related to technology transfer and economic development. While the welfare effects of the inclusion of TRIPS in the WTO were of interest to developing countries, Article 27 (3)(b)[4] of the TRIPS Agreement is of particular concern. Developing countries have proposed that this provision be amended to exclude the patenting of life forms and micro-organisms as they believe that life forms belong to everybody, not to a few who can manipulate their genetic composition. Environmentalists fear that genetic engineering could contribute towards lack of control and accountability in biotechnology research and application, accelerate biodiversity loss and threaten natural ecosystems. The race by pharmaceutical multinationals to co-opt and patent useful herbs and indigenous technology under the TRIPS Agreement presents an increased threat to biodiversity and threatens the sovereignty of developing countries and the livelihood and heritage of their people.[5]

Khor[6] states that the issue of patenting is particularly disturbing. Supporters of the need to patent new technology say that paying for the use of such inventions rewards innovation and generates revenues for further research. The original intention of the inclusion of the TRIPS Agreement in the GATT was to prevent pirates from passing off inferior products as cheap substitutes. Actual implementation of the Agreement has had vastly different results. Khor states that patent laws enable foreign firms to capture more profits through royalties or the sale of their restricted technology products, while restricting competition by preventing rivals from developing a similar technology. This creates firms with monopolies in the production of specific products and correspondingly higher prices. While developing countries are asked to open their borders to more imports and foreign investors, developed countries are able to keep their technology locked in.

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4 This provision states that Members may exclude from patentability plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes. Members shall provide for the protection of plant varieties, however. This may be done by patents or by an effective *sui generis* system or by any combination thereof. The provisions of this sub-paragraph were to be reviewed four years after the date of entry in force of the WTO Agreement (WTO, op cit note 1 at 380-1).

5 Azacon-La Cruz (1999:18).

6 Khor, as cited in Azacon-La Cruz, op cit note 5 at 20.

Unlike most GATT provisions which relate directly to trade and can therefore be directly linked to a previous GATT provision or principle, the TRIPS Agreement deals with a direct legal matter *ie* the protection of intellectual property rights. Given that the GATT is committed to the reduction or elimination of protection within the global arena, it seems odd that the WTO should be the chosen forum for the enforcement of intellectual property protection. Prior to the GATT Agreement on TRIPS, the World Intellectual Property Organisation (WIPO) was the appropriate forum for the discussion of intellectual property protection. While the WIPO agreements provide for national intellectual property protection to be extended to foreigners, *ie* that there be no discrimination between nationals and foreigners,[7] countries are free to determine nationally their level of intellectual property protection.[8]

Parties seeking protection of intellectual property were unhappy with the level of intellectual property protection and sought to increase the level of protection within the WIPO context. However these efforts were unsuccessful as developing countries did not on balance perceive increased intellectual property protection to be in their interests. The developed economies and other major exporters of technology were aware that a trade-off could only be successfully made in a trade context. The Uruguay Round was seen as offering the possibility of trade-offs between topics on the negotiating agenda so that countries who were asked to compromise on a given issue could seek countervailing benefits in another. One of the reasons given for the transferral of intellectual property issues to the GATT has been that WIPO lacked effective international enforcement mechanisms. Subramanian[9] is of the opinion that the main reason for the change was that those countries who are major exporters of technology felt that the WIPO context did not offer them sufficient leverage with which to change the regime.

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7 Article 2(1), *Paris Convention for the Protection of Industrial Property of March 20*, 1883, as revised at Stockholm on July 14, 1967. Article 7 of the Berne Convention for the Protection of Literary and Artistic works is an exception as it prescribes a set of minimum standards for the level of copyright protection.

8 Article 2(3), op cit note 7.

9 Subramanian , op cit note 2 at 511.

8.3 The welfare effects of TRIPS

Patent rights seek to protect inventors and ensure future invention. There is an assumption made that without patent protection, inventors would not have any economic incentive to create, thus depriving consumers of the benefits linked to innovation. Without patent protection, both inventor and consumer would therefore lose. This is an assumption which Deardorff disputes. Deardorff[10] states that the loss to consumers assumes that the inventor would not have succeeded in pricing as a perfectly discriminating monopolist and hence in extracting all the potential consumer surplus. Once a limited system of patent protection is in place, which provides inventors with exclusive rights to sell their inventions to a certain market that is limited in time or in space, there may then be both costs and benefits attached to the extension of protection to a larger market. Both costs and benefits arise from the fact that patent rights grant the patent holder the right to charge a monopoly price, or to collect the economic rents from charging such a price by licensing someone else to do so. Monopoly prices do distort consumer choice, however, and this leads to a sub-optimal quantity of invented goods being consumed. This is a cost, so long as some positive amount of invention would have occurred without extending the market. Because consumers of the invented goods have to pay monopoly prices instead of the lower perfectly competitive prices, they will consume less of the goods that are invented and will therefore enjoy less consumer surplus than would have been possible. On the other hand, because consumers do derive some consumer surplus even with monopoly pricing, the inventor does not earn monopoly profits equal to the entire benefit to society that is generated from their inventions. The incentive to invent is not as great at the margin as it should be from society's viewpoint, resulting in a sub-optimal level of invention. In a world where many potential inventions are possible, there will be some inventions which could have benefited consumers more than they cost to invent, but that inventors will not have found it profitable to pursue.[11]

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10 Deardorff (1990:501). See also Subramanian, op cit note 2 at 518-521, Trebilcock and Howse (1999:307-312), and McCulloch, Winters and Cirera (2001:212-214).

11 Deardorff, op cit note 10 at 502.

In the case of an additional or foreign market which has not previously granted patent protection the welfare effects are dependent on whether or not a competitive supply of the invented good already exists in the foreign market. If the monopolist inventors were previously able to deny potential producers in that market access to their technology, partly by refusing to sell their products to the market's consumers, then the extension of patent protection will create only benefits. Foreign consumers gain access to the new products, which they did not previously have. Monopolist inventors in the home market gain additional monopoly profits on foreign sales of the goods foreigners would have invented themselves. The additional profits expand the return on invention and cause more invention to be undertaken. These additional inventions generate additional monopoly profit for inventors, plus additional consumer surplus for consumers in both markets. Where denial of patent protection in a market also denies to consumers in that market access to the invented goods, the extension of patent protection to the market is welfare improving for everyone.[12] The situation is different where producers in the protected market do not manage to keep their technology secret and a competitive supply of the invented products is available in the unprotected market. In the case of free foreign access to technology, the extension of patent protection still creates a benefit. If competitive supplies are eliminated in the newly protected market, the inventing firms will earn additional monopoly profits and additional returns on their inventions. As the level of invention was already sub-optimal, the resulting expansion of invention will increase world welfare. The benefits of extending patent protection to an additional market are increased profit and consumer surplus in both markets on the goods that are invented only as a result of extending protection.

There are also costs, however. All the goods which were available on the unprotected market previously will now be subject to monopoly pricing. This will cause their consumption to be reduced to a sub-optimal level. The loss to these foreign consumers will exceed the gain in monopoly profits to the supplier, with the difference being a welfare loss for the world as a whole. There is also an additional effect of extending patent protection where there is neither a benefit nor a cost to world welfare. Here the effect is the transfer of welfare from foreign consumers to domestic monopoly inventors. This welfare transfer is equal to the monopoly profits earned in the presence of patent

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12 Loc cit.

protection on foreign sales. Even if neither foreign consumption nor the level of invention were to change in response to incentives, so that the benefits and costs calculated above are zero, the transfer of welfare could be considerable.[13]

Subramanian[14] supports this conclusion, stating that the welfare of the technology importing countries deteriorates but global welfare increases in situations where greater patent protection reduces imitation of new technology, or reduces discrimination which favours nationals above foreigners in relation to research and development. Subramanian notes that the configuration of global welfare gains but national losses is alien to the traditional GATT paradigm where national policy actions, for example, tariff or quota reductions, simultaneously increase national and global welfare. He argues that in principle the GATT paradigm is suited to cope with the distributional aspects because it provides for implicit compensation mechanisms. The GATT negotiating rounds provide for reciprocity, a mechanism which becomes more important if there are welfare losses for individual countries, as is the case in TRIPS. Despite the possibility of positive reciprocity offered by the GATT, the TRIPS Agreement has been shadowed by the issue of bilateralism.

Subramanian argues that Section 307[15] of the US trade law has pre-empted and defined the outcome of TRIPS to a considerable extent. At least some of the important changes which should have been

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13 Deardorff, op cit note 10 at 503. McCulloch *et al* support this conclusion, stating that the introduction of minimum standards of IPR protection may have a negative welfare impact on developing countries with low levels of technological diffusion, but could benefit newly industrialised countries with greater technological capacity. Developing countries do not therefore all have identical interests in the TRIPS debate (McCulloch, op cit note 10 at 213).

14 Subramanian, op cit note 2 at 519.

15 The 1984 Amendment to the Section 307 scheme introduced a requirement that the Executive Branch produce a "National Trade Estimates" (NTE) report, which would identify important barriers for US exports. These barriers included a denial of protection for US intellectual property. In 1988, a new "Special 307" section was added which required the United States Trade Representative to use the NTE report as a basis for identifying priority foreign countries which deny adequate and effective intellectual property rights and were not making an effort to eliminate the problem. Having done so, it would then have to self-initiate an investigation of those countries unless it determined that to do so would be detrimental to US economic interests. These investigations proceeded as "discretionary" action cases. The countries under investigation had to adopt US approved intellectual property standards or face trade sanctions and therefore diminished access to US markets. See Jackson (1995:832).

discussed under the auspices of the GATT were attained through bilateral initiatives. Instead of bargaining as equals, countries like South Korea, Singapore, Indonesia, Thailand, Malaysia, Mexico, Argentina, Chile and Brazil had to change their intellectual property policies in order to prevent the US from withdrawing existing market access concessions. The TRIPS negotiations were therefore no longer the object of bargaining and compensatory offers between North and South which they were meant to be. These negotiations exposed the inherent limitation of multilateralism which is that multilateral outcomes need not always be determined by multilateral bargaining, which is meant to protect the least powerful nations from the most powerful world economies. Multilateralism may in fact serve to legitimise the objectives of bilateralism.[16]

An issue of great interest to some developing countries is that of imitation. Some indigenous producers have chosen to imitate global trends and products rather than innovate. While some countries and their domestic producers do not have the resources and capital to innovate, given that research and development requires extensive capital and knowledge inputs, for some firms it is more profitable to imitate. The TRIPS Agreement, with its higher protection of patents and trademarks, will make it very difficult for these firms to survive. Subramanian[17] has analysed the national and global welfare consequences of higher intellectual protection on small and big countries whose domestic producers are predominantly involved in imitation. Subramanian maintains that the most important and plausible situation of conflict arises when a potential technology importer maintains a low level of protection to facilitate cheaper or costless imitation by indigenous producers. This can be compared to a positive supply shock. Where the small country assumption is made in this context, ie that the level of protection has no significant effect on global research and development creation, there are no real dynamic losses. Because of the small country assumption, static gains accrue to the importer whose welfare unambiguously increases. Subramanian believes that this configuration applies to many areas of conflict, for example, pharmaceuticals, software, audio and video cassettes. In the pharmaceutical sector where indigenous producers of several developing countries actively compete, prices are often significantly lower than comparable prices for products abroad. Developing countries

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16 Subramanian, op cit note 2 at 520.

17 Subramanian, op cit note 2 at 514.

individually and even collectively account for a small fraction of global sales in products for which research and development is considered to be important. The likelihood of patent protection in their markets having a significant effect on global research and development is very small.[18]

With a large country assumption the global welfare effects will be greater with higher intellectual property protection. National welfare of the technology-importing country could still be lower with high intellectual property protection, however, because the economic rents appropriated by the foreign creator of technology could outweigh any consumer surplus gains resulting from research and development. An example of this situation could relate to the development of drugs for the treatment of tropical diseases or of technologies, such as seeds or chemicals designed for tropical agriculture. Without intellectual property protection no research and development will be undertaken. A decision by a group of developing countries to increase intellectual protection could increase the incentives for research and development effort in fields of major importance to them. The welfare effect would be dependent on the magnitude of profits accruing to the foreign creator of technology and the terms of access to foreign technology.[19]

The conclusion that stronger intellectual property protection could benefit some countries at the expense of others shows a fundamental difference between the theoretical case for trade liberalisation and the case for seeking high levels of intellectual property protection throughout the world. Neo-classical trade theory suggests that further liberalisation will, with certain defined exceptions, always be beneficial to both the domestic economic welfare of the liberalising state and global economic welfare. Intellectual property protection cannot be expressed in terms of neo-classical trade theory, however, as increased protection results in the transfer of welfare from technology-importing countries to technology-exporting states. Stronger patent protection to intellectual property rights is therefore not necessarily Pareto-superior and has to be justified as a trade-off between the competing economic interests of different states. It is also questionable whether the gains in economic welfare of countries who benefit from stricter protection outweigh the losses of the loser countries, *ie* whether the

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18 Subramanian, op cit note 2 at 514-515.

19 Subramanian, op cit note 2 at 515.

protection is Kaldor-Hicks efficient.[20] Deardorff[21] has argued that global aggregate welfare may be maximised if certain countries are exempted completely from requirements for intellectual property protection. In the case of poorer countries, the marginal increased rents to the patent holder are most probably too little to provide significant incentives to further innovation. The losses to developing countries from the elimination of imitation or buying imitations elsewhere will probably be more substantial. If the effect of increased protection is to shift productive resources from an activity in which a country has a comparative advantage (for example, imitation) to that in which it has less comparative advantage, in this case, innovation, then global allocative efficiency will be reduced by increased protection.[22]

In his economic analysis of higher intellectual property protection, Subramanian[23] deals with the issue of technology transfer. Developing countries have been urged to adopt higher intellectual property protection on grounds that this would facilitate the transfer of technology to developing countries, increase foreign investment and boost growth.While the intellectual property regime may have no influence on the creation of technology, it may influence its transfer because of the possibility of the technology being copied after the transfer is effected. A common occurrence is the use by employers of the knowledge necessary for commercialising an invention for their own gain. This is a moral hazard problem and is common in economic analysis. To prevent this situation, governments usually institute a regime which does not allow *ex post facto* copying and preserves the appropriate incentives for technology transfer. Global and national welfare benefit from higher intellectual property protection in this case. In the global arena increased protection was being sought in sectors where imitation was possible even without the cooperation of the inventor so that the transfer of technology did not have to rely on the provision of incentives to facilitate such transfer. The transfer of technology in this arena was therefore largely irrelevant. In conclusion, Subramanian states that the areas of

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20 Trebilcock and Howse, op cit note 10 at 311. The Kaldor-Hicks compensation criterion states that a change constitutes an improvement in social welfare if those who benefit from it could compensate those who are hurt, and still be left with a nett gain (Cohen, 2001:14).

21 Deardorff, op cit note 10 at 503 to 506. See also Trebilcock and Howse, op cit note 10 at 311-312.

22 Trebilcock and Howse, op cit note 10 at 312.

23 Subramanian, op cit note 2 at 515-517.

conflict are the highly copyable cases, with copyability being defined as the lack of need for technology transfer. The cooperation of the creator is unnecessary where indigenous producers can imitate cheaply. In areas where technology transfer requires the cooperation of the inventor and therefore high intellectual property protection, this has already been provided for.[24]

From Subramanian's analysis of technology transfer, it becomes evident that, while higher intellectual property protection facilitates greater technology transfer, this is not the real area of contention. Higher intellectual property protection is sought in areas where imitation is rife, with developed countries wanting to protect their inventions from piracy and counterfeiting. This suggests that technology transfer, an issue of real relevance to developing countries, is merely an afterthought meant to satisfy developing countries. In the case of imitation, it is evident that while imitation is welfare-increasing in the domestic market because it provides technology at perfectly competitive prices, thus making technology more affordable and more widely available, these consumers benefit at the expense of the innovator. While competition is beneficial to competitors and consumers as well, such competition must be legitimate. Where indigenous companies copy technology from the innovator, without making the proper compensation, especially where the new technology is unique, this amounts to theft. Unlike areas where the sovereignty of developing countries is compromised by trade policies which limit their policy-making flexibility, governments who intentionally adopt low intellectual property provisions cannot ethically claim that this is their right. This is especially so where these governments are aware of and encourage imitation by domestic producers.

An issue which is not referred to in the economic analysis of higher intellectual property protection is the cost of implementing and maintaining higher intellectual property protection, especially in least-developed economies which lack the necessary infrastructure to maintain basic legislative and administrative provisions. Where these countries are dependent on revenue from the imitation of technology, the administrative costs, together with the loss of imitation revenue, will place an additional burden on their economies.

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[24] Subramanian, op cit note 2 at 517.

Increased intellectual property protection is generally deemed to be welfare-increasing as it increases monopoly profits to the inventor while ensuring that consumers benefit from greater innovation. Within the context of developing economies, especially those countries which have previously adopted low levels of intellectual property protection, increased intellectual property protection brings a mixed bag of blessings. Higher protection results in the transfer of benefits from consumers to producers, who reap greater monopoly profits. In return, consumers are subjected to higher prices on goods, and perhaps, more diverse products. Higher intellectual property protection may, however, attract producers who no longer fear imitation. Where there is collaboration with domestic firms, transfer of technology may occur. This outcome is, however, merely speculative. As most firms involved in research and development and innovation are situated in developed economies, greater intellectual property protection will result in the transfer of welfare gains from developing to developed markets. In the case of pharmaceutical products, for example, diminished availability of imitated or generic drugs will have negative welfare effects on indigenous populations who can ill afford to purchase the original products.

Where imitation occurs out of necessity, that is, countries are unable to afford research and development, it is unlikely that higher intellectual property protection will stimulate innovation within domestic markets. Where imitation is merely a profitable alternative, however, higher intellectual property protection may encourage greater research and development in developing countries, resulting in greater innovation. Where this occurs, developing economies may benefit from monopoly rents. Imitation has provided developing economies with a cheaper alternative than higher priced original goods. It also indicates a lack of technology and resources. Unless higher intellectual property protection is linked to technology transfer, economic and welfare benefits will continue to flow from developing to developed economies, regardless of the level of innovation facilitated by higher protection.

8.4 The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

The TRIPS agreement, unlike the TRIMs Agreement, is a very detailed agreement which takes into account the existing obligations which Members may have made to each other under the Paris Convention, the Berne Convention, the Rome Convention and the Treaty on Intellectual Property in Respect of Integrated Circuits.[25] In respect of Parts II, III and IV of the TRIPS Agreement, Members must comply with Articles 1 to 12, and Article 19, of the Paris Convention (1967). The provisions which are of importance to developing countries or could have some bearing on the discussion on barriers to growth and development will be considered in this section.

Articles 1 to 12 of the Paris Convention (1967) provide for the general protection and administration of intellectual property rights. Article 2(1) provides for national treatment of industrial property protection. This provision is mirrored by Article 3(1) of the TRIPS Agreement which provides that Members are to accord to the nationals of other Member states treatment no less favourable than it accords to its own nationals with regard to the protection of intellectual property. National treatment is subject to the exceptions already provided for in the Paris Convention (1967), the Berne Convention (1971), the Rome Convention and the Treaty on Intellectual Property in respect of Integrated Circuits. None of these exceptions are relevant to the protection of patents, however. A provision relevant to the discussion of patents, especially in the context of Article 27(3)(b) of the TRIPS Agreement, is Article 10 bis of the Paris Convention (1967). This provision states that contracting states may protect nationals against unfair competition by providing effective protection.[26] Any act of competition contrary to honest practices in industrial or commercial matters is deemed to constitute an act of unfair

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25 Article 2(2), the TRIPS Agreement, WTO, op cit note 1 at 368. The Conventions referred to are the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literacy and Artistic Works, and the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations, Rome 26 October 1961 respectively. The Treaty on Intellectual Property in Respect of Integrated Circuits is also known as the IPIC Treaty.

26 Article 10 bis (1).

competition.[27] The following acts are prohibited:[28]

a) all acts designed to create confusion by any means whatever with the establishment, the goods, or the industrial or commercial activities, of a competitor;
b) false allegations in the course of trade which seek to discredit the establishment, the goods, or the industrial or commercial activities, of a competitor;
c) indications or allegations which, if used in the course of trade, are liable to mislead the public as to the nature, the manufacturing process, the characteristics, the suitability for their purpose or the quantity, of the goods.

Article 19 of the Paris Convention (1967) provides contracting parties with the right to make separately between themselves special agreements for the protection of industrial property, in so far as these agreements do not contravene the provisions of the Convention. This provision provided the foundation for the bilateral negotiations between the US and other contracting parties which were targeted under Special 301. Article 1(1) of the TRIPS Agreement provides that Members may, but are not obliged to, implement in their law more extensive protection than is required by the TRIPS Agreement, provided that this protection does not contravene the provisions of the Agreement. Members are also free to determine the appropriate method of implementing the provisions of the Agreement within their own legal system and practice. In formulating or amending their laws and regulations, Members may adopt measures necessary to protect public health and nutrition, and to promote the public interest in sectors of vital importance to their socio-economic and technological development, provided that these measures are consistent with the provisions of the TRIPS Agreement.[29]

Where they are consistent with the provisions of the TRIPS Agreement, appropriate measures may be implemented to prevent the abuse of intellectual property rights by right holders or the resort to

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27 Article 10 bis (2).

28 Article 10 bis (3)(1) to (3).

29 Article 8(1), WTO, op cit note 1 at 370.

practices which unreasonably restrain trade or adversely affect the international transfer of technology.[30] The objective of the TRIPS Agreement is that the protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and the transfer and dissemination of technology to the mutual advantage of producers and users of technological knowledge. This should be done in a manner conducive to social and economic welfare, and to a balance of rights and obligations.[31] Regarding the issue of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be extended immediately and unconditionally to nationals of all other Members.[32] Advantages derived from international agreements on judicial assistance or law enforcement of a general nature and not particularly confined to the protection of intellectual property are exempt from this provision.[33]

Advantages derived from intellectual agreements related to the protection of intellectual property which entered into force prior to the entry into force of the WTO Agreement are also exempt from the most-favoured national treatment clause. These agreements must be notified to the Council for TRIPS, however, and cannot constitute an arbitrary or unjustifiable discrimination against nationals of other Members.[34] Given that Members may adopt higher intellectual property protection standards than provided for within the TRIPS Agreement, there is nothing in the Agreement which prevents states from bilaterally agreeing to the adoption of higher standards. Where a state provides higher intellectual property protection to another Member, by virtue of the most-favoured nation treatment clause in Article 4, that state will have to extend the same treatment to all Members. Intellectual property protection standards can be increased bilaterally, and through the multinational framework other Members may be forced to adopt standards which they would not have agreed to during multinational negotiations. Given that the TRIPS Agreement now provides a multilateral framework

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30 Article 8(2), WTO, op cit note 1 at 144.

31 Article 7, WTO, op cit note 1 at 144.

32 Article 4, WTO, op cit note 1 at 369.

33 Article 4(a), WTO, op cit note 1 at 369.

34 Article 4(d), WTO, op cit note 1 at 369.

in which Members may bargain for increased protection, Article 19 of the Paris Convention (1967) is too broad and can be abused.

Part VI of the TRIPS Agreement makes provision for transitional arrangements. Article 65 (1) provides that no Member will be obliged to apply the provisions of the TRIPS Agreement before the expiry of a general period of one year following the date of entry into force of the WTO Agreement. Developing countries are entitled to delay compliance with the provisions of the TRIPS Agreement, other than Articles 3,4 and 5, for a further period of four years from the date of application.[35] Where a developing country Member is obliged by the TRIPS Agreement to extend product patent protection to areas of technology not so protected in its territory on the general date of application of the Agreement for that Member, it may delay the application of the provisions on product patents of Section 5 of Part II to such areas of technology for an additional period of five years.[36] Members referred to in paragraphs 1-4 of Article 65 must ensure that any changes to their laws, regulations and practice made during the transitional period do not result in a lesser degree of consistency with the provisions of the TRIPS Agreement.[37] Because of the special needs and requirements of least-developed country Members, their economic, financial and administrative constraints and their need for flexibility to create a viable technological base, the least-developed country Members are not subject to the provisions of the TRIPS Agreement, other than Articles 3, 4 and 5, for a period of 10 years from the date of application as defined by Article 65(1). The Council for TRIPS will, upon receipt of a duly motivated request by a least-developed country Member, extend this period accordingly.[38] Developed country Members must provide incentives to enterprises and institutions in their territories, for the purpose of promoting and encouraging technology transfer to least-developed

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35 Article 65(2), Agreement, WTO, op cit note 1 at 398. Articles 3 and 4 refer to the national treatment and most-favoured nation treatment principles respectively. Article 5 provides that the obligations under Articles 3 and 4 do not apply to procedures provided in multilateral agreements concluded under the auspices of WIPO relating to the acquisition or maintenance of intellectual property rights.

36 Article 65(4), WTO, op cit note 1 at 398. Section 5 of Part II of the TRIPS Agreement refers to the protection of patents under the Agreement.

37 Article 65(5), WTO, op cit note 1 at 398.

38 Article 66(1), WTO, op cit note 1 at 399.

country Members in order to assist them in creating a sound and viable technological base.[39] Developed country Members must also provide technical and financial cooperation to developing and least-developed country Members on request and on mutually-agreed terms and conditions. This cooperation must include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights as well as on the prevention of abuse. Assistance must also include support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters, including the training of personnel.[40]

By temporarily excluding the least-developed economies from the TRIPS Agreement for a period of ten years, these countries have been temporarily spared the domestic welfare loss which they would have experienced otherwise. Article 66(2), which provides that developed country Members must provide incentives to create a sound and viable technological base, can only help developing countries and least-developed economies. The provision of aid by developed economies, both technical and financial, to assist in the implementation of the Agreement by developing and least-developing economies is another positive provision, as basic infrastructure is lacking within these economies. Given that the greater intellectual property protection is being adopted primarily to protect developed country innovators, it makes sound economic sense that these countries take responsibility for some of the costs which the developing countries would otherwise have to bear in implementing provisions which are of no short-term benefit to them.

The general provisions of the TRIPS Agreement are not of any real concern to developing countries. The effect of Article 27(3)(b) is however of concern, as developing countries fear that genetic manipulation of indigenous plant species will make it easier for multinationals to copy and confiscate indigenous processes responsible for the originality and diversity of developing country exports. An example considered in more detail below is that of rice varieties. Developing countries are concerned that the control of nature and distribution of new life forms by TNCs may affect their food security, development and trade prospects. There have been major economic, environmental and ethical

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39 Article 66(2), WTO, op cit note 1 at 399.

40 Article 67, WTO, op cit note 1 at 399.

concerns about life form patenting. Countries fear the negative effect of patenting on consumer rights, biodiversity conservation, environmental protection, indigenous rights, scientific and academic freedom and the development of many developing countries dependent on new technologies. It is for these reasons that many WTO Member states prohibit the granting of life form patents under patent protection for biotechnological inventions.

The TRIPS Agreement is the first international instrument which requires intellectual property protection for life forms. Under Article 27(3)(b) a country may exclude from patentability plants, animals and essentially biological processes for the production of plants and animals. Countries must, however, allow patents for microorganisms and non-biological and microbiological processes for the production of plants and animals. A country must also provide protection for plant varieties, either by patents or by an effective *sui generis* system or a combination thereof. Article 27(3)(b) is deemed to represent a new development in intellectual property law as it blurs the distinction between inventions which are patentable under normal patent law and discoveries which are not.[41] Article 27(1)[42] provides that patents shall be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application. With genetic manipulation, scientists are merely rearranging the genetic sequences of the DNA strand. With patents on discoveries, which are not allowed, reference is made to cell lines, genomes and genes from natural organisms.[43] An example is the collection of cell lines and genes belonging to Amazonian Indians without their proper informed consent.

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41 Oh (1999:8).

42 TRIPS Agreement, WTO, op cit note 1 at 379.

43 A cell line is a supposedly genetically uniform population of cells derived from one individual or could be a clone of one original cell. The genetic identity of all the cells is a fiction, as the genetic material is subject to many "fluid genome" processes which constantly differentiate cells from one another. A genome is the totality of all the genetic material (DNA) in an organism which is organised in a precise way. Most viruses have RNA as genetic material. A gene is a stream of genetic material, either DNA or RNA, with a defined function in the organism or cell, which normally codes with protein. There are many genes within a genome. A DNA sequence refers to a sequence of bases in a stretch of DNA. DNA is a linear molecule consisting of units strung together. There are four different units, each identified by the specific base contained. There are four different bases, each represented by the letters A.T. C and G. An example of a DNA sequence is ATTTCCGCTAACGCGTAA . An RNA sequence is similar, except that U replaces the letter T (Ho and Traavik, 1999:130).

Patents on processes are allowed as inventions. An entire class of patents on extracts from plants which has been developed and used for thousands of years by indigenous communities has arisen. This is one way in which developing country inhabitants have been cheated . Examples are patents from extracts of the neem plant taken from India and extracts from the bibiru and cunoni from the Wopixona Indians in North Brazil. Ho and Traavik suggest that this class of patents can be excluded by an appropriate protection of indigenous knowledge, restriction on exports of plants and animals and agreements on the *ex situ* collections. Transgenic plants, animals and micro-organisms, are seen as inventions as they constitute new constructs or gene combinations created in the laboratory. Patents on transgenic seeds prevent farmers from sowing seeds without paying royalties. Companies like Monsanto in the USA and Zeneco of Britain are attempting to program death in the second generation into the seed sold to farmers so that farmers will be forced to buy new patented seed every year. This is being done through genetic engineering.[44] With TNCs buying up most seed companies, this introduces an effective seed monopoly that will dominate family farmers throughout the world and destroy agricultural biodiversity. There are also patents on all micro-organisms isolated or identified and patents on nuclear-transplant cloning and other *in vitro* reproductive techniques, and organisms resulting from these techniques. The patents on all micro-organisms would have included any micro-organisms isolated, subject to an agreement which was subsequently successfully challenged by the Edmonds Institute on behalf of civil society. The patent on nuclear-transplant cloning extends to the cloning of human beings.[45]

An issue which highlights the danger which genetic engineering poses to developing countries' farmers and natural resources is the India-USA Basmati Rice Dispute. An American company Ricetec Inc was granted a patent by the US patent office to call an aromatic rice grown outside India and Pakistan "Basmati". With the Basmati patent rights, Ricetec will now be able to call its aromatic rice Basmati within the US. Ricetec may also label its rice Basmati for exporting. This will have grave repercussions for India and Pakistan who will lose out on their US, European Union, United Kingdom, Middle East and West Asian markets. The Indian government has urged the US patent office to re-

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44 For more on biological genetic engineering, see Egzibher (1999:4-6).

45 Ho and Traavik, op cit note 43 at 13-14.

examine the patent to a US firm to grow and sell rice under the Basmati brand name in order to protect India's interests, particularly those of growers and exporters.[46]

Members of the Food and Agriculture Organisation (FAO) Commission on Plant Genetic Resources adopted the International Undertaking on Plant Genetic Resources in 1983. The objective of this non-binding instrument is "to ensure that plant genetic resources of economic and/or social interests, particularly for agriculture, will be explored, preserved, evaluated and made available for plant breeding and scientific purposes."[47] Breeders expressed their dissatisfaction at having to make their materials available to everyone and sought clarification of their rights. This resulted in Resolution 4/89[48] which recognised breeders' rights, as provided for under the International Union for the Protection of New Varieties of Plants (UPOV). Paragraph 3 of Resolution 4/89 recognises the enormous contribution that farmers of all regions have made to the conservation and development of plant genetic resources, which constitute the basis of worldwide plant production and form the basis of the concept of farmers' rights. Paragraph 4 provides that the best way to implement the concept of farmers' rights is to ensure the conservation, management and use of plant genetic resources for the benefit of present and future generations of farmers.[49]

Resolution 5/89 on "Farmers' Rights" was adopted in the same year. It describes farmers' rights as rights arising from the past, present and future contributions of farmers in conserving, improving and making available plant genetic resources, particularly those in centres of origin or diversity. These rights are vested in the international community, as trustee for present and future generations of farmers, for the purpose of ensuring full benefits to farmers and supporting the continuation of their

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46 TED webpage: *http://www.american.edu/projects/mandala/TED/basmatic.htm* (2002-07-08). In addition to Basmati rice, a Japanese firm has applied for a patent on curry (McCulloch *et al*, op cit note 10 at 216).

47 International Undertaking on Plant Genetic Resources, Resolution 8/83, Twenty-second Session of the FAO Conference, Rome 5-23 November 1983, (Kate and Lasen Diaz, 1997:285).

48 Adopted on 29 November 1989.

49 Loc cit.

contributions. It is also the responsibility of the international community to:[50]

a) ensure that the need for conservation is recognised globally with sufficient funds being made available for this purpose;

b) assist farmers and farming communities throughout the world, but especially those in the areas of origin, diversity or plant genetic resources, in the protection and conservation of their plant genetic resources, and of the natural biosphere;

c) allow farmers, their communities, and countries in all regions, to participate fully in the benefits derived from the improved use of plant genetic resources through plant breeding and other scientific methods.

In 1993, Resolution 3 of the Food and Agricultural Organisation (FAO) Conference recognised that the concept of man's heritage is "subject to the sovereignty of the states over their plant genetic resources".[51] Regarding the conditions of access to plant genetic resources, the Resolution provided that states have sovereign rights over their plant genetic resources. Breeders' lines and farmers' breeding material should be available only at the discretion of their developers during the period of development. The Resolution provided further that farmers' rights will be implemented by an international fund on plant genetic resources which supports plant genetic conservation and utilisation programmes particularly, but not exclusively, in developing countries.[52]

Because the FAO instruments are in the form of Resolutions, they are non-binding, although some commentators have argued that these Resolutions may have acquired international legal significance

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50 Resolution 5/89 on "Farmer's Rights", CPGR-Ex1/94/Int.1, September 1994, Kate and Lasen Diaz, op cit note 47 at 285. A legal revision of the UPOV convention substantially extends breeders' rights. Authorities are allowed to extend breeder's rights to the harvest in some circumstances, with breeders being given control over the varieties derived from their protected variety. It also reduces the status of farmer's privilege from a right to an option that authorities can grant (McCulloch *et al*, op cit note 10 at 218).

51 FAO Resolution 3/91, paragraph 1.

52 Loc cit.

as evidence of customary law.[53] The revisions of the International Undertaking on Plant Genetic Resources to bring it into harmony with the Convention on Biological Diversity (CBD) has cast doubts on its status as customary international law. The Convention endorses state sovereign rights over their natural biological resources and the consequent authority of national governments to determine access to genetic resources. Access will be subject to parties' informed consent on mutually agreed terms that promote the fair and equitable sharing of benefits.[54] The concept of farmers' rights was of great concern to the USA, Canada and Australia, as these countries were anxious to avoid the elevation of the concept to that of a legal right, given that the International Undertaking on Plant Genetic Resources could become a legally binding protocol to the CBD. The CBD, in the end, opted for the indirect protection of farmers' rights, vesting sovereignty over natural resources and the right to grant access to genetic resources in national governments. The knowledge, innovations and practices of indigenous and local communities are considered key to the conservation and sustainable use of biodiversity. Governments are required to respect, preserve and maintain these elements.[55] Governments must also protect customary use of bio-resources,[56] act according to national law to develop and use traditional and indigenous technologies[57] and adopt economically and socially sound measures that act as incentives for the conservation and sustainable use of components of biological diversity.[58] The overall effect of these provisions is to make it compulsory for governments to enact laws recognising indigenous and local community knowledge systems.

CBD member countries are bound to ensure that patents and other intellectual property rights enforced support the objectives of the Convention and do not undermine them.[59] The WTO Trade and

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53 Kate and Lasen Diaz, op cit note 47 at 286.

54 Article 15, Convention on Biological Diversity, June 1992 (Kate and Lasen Diaz , op cit note 47 at 286).

55 Article 8(j), Convention on Biological Diversity, Nijar (1999:16).

56 Article 1(d), Nijar, op cit note 55 at 16.

57 Article 18 (4), Nijar, op[cit note 55 at 16.

58 Article 11, Nijar, op cit note 55 at 16.

59 Article 16(5), Nijar, op cit note 55 at 17.

Environment Committee and the EU are of the view that the WTO and the CBD should be mutually supportive. Given that nearly all WTO Member states, with the exception of the USA, are also parties to the CBD, this will ensure that international obligations and understanding allow for the protection of the rights of indigenous peoples and local communities.[60]

Because the USA is not a CBD Member, India cannot rely on the provisions of the Convention at present. The Indian government is relying on Article 22 of the TRIPS Agreement, however, as it maintains that by granting the rice patent, the USA has violated the geographical indications provisions of the TRIPS Agreement. Article 22(1) of the TRIPS Agreement provides that geographical indications are "indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin". In the case of geographical indications, Members must provide the legal means for interested parties to prevent:[61]

a) the use of any means in the design or presentation of a good which indicates or suggests that the good in question originates in a geographical area other than the true place or origin, in a manner which misleads the public as to the geographical origin of the good;
b) any use which is an act of unfair competition within the meaning of Article 10 bis of the Paris Convention (1967).

Article 22 is not the only provision available to developing countries seeking to protect the rights of indigenous peoples and local communities. The TRIPS Agreement provides countries with many opportunities to implement the necessary legislation protecting indigenous resources. Nijar[62] argues

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60 Nijar, op cit note 55 at 16. Article XXIII(2) enables Members to consult with an appropriate intergovernmental body where the matter is serious enough to justify such action. Should the WTO adopt the recommendations of the Trade and Environmental Committee, the US will have no option but to abide by the provisions of the CBD, even though it has abstained from membership of the Convention.

61 Article 22(2), WTO, op cit note 1 at 375.

62 Nijar, op cit note 55 at 17-20.

that Article 1(1), Article 18(4), Article 27 (2) and Article 27(3)(b) of the TRIPS Agreement all provide developing countries with the opportunity to provide relevant protection to indigenous and local community rights. Article 1(1) enables states to provide more extensive protection than that provided by the TRIPS Agreement, provided that this protection is not contrary to the provisions of the Agreement. The TRIPS Agreement specifies a set of minimum obligations in each area of intellectual property law. Countries are not constrained from setting up a different area of protection with broader rights. Areas outside TRIPS are permissible. Some such examples are protection of minor mechanical inventions by Spain, Germany, Japan, Brazil, Mexico, Argentina and the Andean Group countries, as well as the European Union Directive on the Legal Protection of Data Bases (No.96/9). Legislation recognising the creativity of indigenous peoples and local communities may therefore be enacted without violating the TRIPS Agreement.[63]

Article 8 enables Members to take measures to protect public health and nutrition and to promote the public interest in sectors of vital importance to their socio-economic and technological development.[64] Nijar argues that 80 percent of the world's people, living almost entirely in developing countries, depend upon traditional medicine and medicinal plants for their health needs. Measures taken to protect the knowledge system that makes this resource available would be measures to protect public health. The protection of community knowledge and indigenous technology which provide sources of medicine could result in the development of new resilient plant varieties, protect biodiversity and enhance its sustainable use, and provide a host of other useful products and processes which are of vital importance to developing countries' socio-economic development. Tampering with this system could cause serious instability within these economies. Measures taken under Article 8 must be consistent with provisions of the TRIPS Agreement and the objectives of the Agreement as set out in Article 7 which provides that intellectual property protection should contribute to the promotion of technological innovation in a manner conducive to social and economic welfare. Protective legislation

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63 Nijar, op cit note 55 at 17.

64 Article 8(1), WTO, op cit note 1 at 370.

can therefore be enacted in accordance with Article 8(1) of the TRIPS Agreement.[65]

Article 27(2) enables Members to exclude inventions from patentability where this is necessary to protect *ordre public* or morality from commercial exploitation. Protection may be extended to human, animal or plant life or health to avoid serious prejudice to the environment, provided that this exclusion is not made merely because the exploitation is prohibited by law. Article 27 (3)(b) states that Members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof. These provisions could be utilised to provide legislation or a system of law which protects biodiversity within developing countries.

Study of the TRIPS Agreement shows that developing countries are not without options when it comes to the protection of their natural resources and traditional knowledge. What makes these countries easy targets is their ignorance of their options and their refusal to adopt more effective intellectual property protection, either on philosophical or economic grounds. Paragraph 12 of WTO Appellate Body on the *"India-Patent Protection for Pharmaceutical and Agricultural Chemical Products" Case*[66] indicates the general attitude of these countries. The USA had taken India to the Dispute Settlement Body for failing to bring its transitional regime for patent protection of pharmaceutical and agricultural products into conformity with its obligations under Article 70 (8)(a) of the TRIPS Agreement.[67] In its defence, India maintained that Article 70(9) of the TRIPS Agreement is part of the transitional arrangements of the TRIPS Agreement whose very function is to enable developing countries to postpone legislative changes. Patent protection for pharmaceutical and agricultural

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65 Nijar, op cit note 55 at 17. For a more in depth discussion of options available to developing economies, see the above cited article at 17-21. An option worth mentioning is that by Whalley (1999:25) who proposes that developing countries could use TRIPS as a forum for asserting their property rights over traditional remedies and practices of various kinds, with compensation to governments when used.

66 WT/DS50/AB/R,05/09/1997 at page 5.

67 Article 70(8)(a) provides that "where a Member does not make available as of the date at entry into force of the WTO Agreement patent protection for pharmaceutical and agricultural chemical products commensurate with its obligations under Article 27, that Member shall notwithstanding the provisions of Part VI (transitional arrangements) provide as from the date of entry into force of the WTO Agreement a means by which applications for patents for such inventions can be filed" (WTO, op cit note 1 at 401).

chemical products is the most sensitive TRIPS issue in many developing countries. To India, the Panel's interpretation of Article 70(1) should enable developing countries to postpone legislative changes in all fields of technology especially in the most sensitive ones.

India's attitude towards the introduction of patent protection legislation is typical of most developing countries who act only when they have to, and then only to make the minimum changes required by international agreements. The passive approach of these countries is a stark contrast to the more active approach of developed economies, and especially of TNCs who are aware of the legislative weakness of most developing economies.

8.5 Does the TRIPS Agreement discriminate unfairly against developing economies?

The test for unfair discrimination begins with the question of whether there is a recognition of differences amongst states. The TRIPS Agreement recognises that developed and developing economies are different and has made provision for these differences. A further division has been made between normal developing and least-developed economies, who are deemed by the various Agreements to be in need of more preferential treatment than other developing economies because of their lack of economic growth and development. Similarly situated states are therefore treated similarly while differently situated states are treated differently.

Given that there appears to be recognition of differences between developed and developing economies, the next step is to determine the nature and impact of the differentiation. Although the TRIPS Agreement is applicable to all states, differentiation relates to the period given to states or groups of states in which they may implement the provisions of the TRIPS Agreement. Least-developed economies are exempt from nearly all provisions for a period of ten years while other developing states may delay the period of implementation of the Agreement for four years. Where patent protection has not previously been extended to specific sectors of technology, developing economies have delayed the period of application for a further five years. Members who fall under the category of economies under transition, that is, former states of the USSR, may also delay the

period of implementation of the Agreement for a period of four years after the date of application. Differentiation within this context is therefore not linked to the actual provisions of the TRIPS Agreement but to the implementation of the Agreement itself.

Having determined the nature of the discrimination, it is necessary to ascertain whether the differentiation amounts to unfair discrimination. While discrimination may be unfair because it impacts negatively on the affected states, discrimination which does not actually address the inequalities experienced by disadvantaged groups is also unfair. In order to determine whether discrimination is unfair, it is necessary to find out whether there is a rational connection between differentiation in the TRIPS Agreement and a legitimate WTO objective, whether the Agreement is proportional and efficient, and if it addresses power issues.

The TRIPS Agreement seeks to promote effective and adequate protection of intellectual property rights, reduce distortions and impediments to international trade and to ensure that the measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade. Members also recognise the special needs of the least-developed country Members in respect of maximum flexibility in the domestic implementation of laws and regulations. The purpose of special treatment is to enable the least-developed countries to create a sound and viable technological base.[68] Obtaining a standardised set of rules for intellectual property protection within the WTO is a legitimate objective as is the protection of intellectual property rights. Within this context, the need to provide least-developed economies with maximum flexibility in the implementation of laws and regulations is a rational objective given that most least-developed economies do not have adequate controls on intellectual property protection or a ready legal infrastructure upon which to base WTO intellectual property regulations. Providing least-developed and other developing economies with more leeway regarding implementation makes sense in these circumstances, especially where states are not sufficiently developed to need particular categories of intellectual property protection. There is therefore a rational connection between the TRIPS Agreement differentiation and a legitimate WTO purpose.

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68 WTO, op cit note 1 at 366.

Differentiation, within the context of this Agreement, is limited to the period of implementation, which, given that the goal of the differentiation is flexibility, is reasonable. While greater flexibility may delay the transfer of economic rents from developing economy consumers to inventors of technology within the mainly developed economies, this delay cannot be deemed to constitute unnecessary harm on the inventors of technology as it does not impose burdens upon them which they have not experienced previously. As the greater flexibility is designed to ensure that intellectual property protection within developing and least-developed economies is implemented efficiently, the differentiation will ultimately contribute towards the increased welfare of innovators. The greater flexibility given to developing economies is also meant to benefit the developing economies themselves as it enables them to standardise and upgrade their intellectual property laws. Where states are concerned with piracy and/or theft of indigenous resources because of genetic engineering, greater flexibility in implementing the TRIPS Agreement provides states with the time needed to adopt and implement national legislation designed to protect indigenous resources, if they are so inclined. The greater flexibility given to developing economies is therefore proportional as the means do justify the ends.

As to the efficiency of the differentiation, this is dependent upon the attitude with which the developing countries approach their task. Proper regulation of intellectual property is dependent upon a well-developed, fully-functioning system which is able to handle the complexity of changing technology and scientific development. Where legal systems with the proper support base already exist, this does not present a problem. Where countries have only rudimentary legal systems unable to handle the complications of scientific and technological advances, it is doubtful whether four years or ten years will suffice. Without assistance, flexibility of implementation alone may not suffice. The TRIPS Agreement does make provision for the technical and financial cooperation of developing and least-developed country Members with developed country Members. Such assistance is to be provided by developed Members on request and on mutually agreed terms and conditions and is to include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights and on the prevention of their abuse. Assistance is also to include support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters,

including the training of personnel.[69]

Cooperation between developing and developed economies on the implementation of intellectual property laws will enable the developing states to make their implementation deadlines. This provision is, however, dependent on the ability of developed and developing states to come to mutually-agreed terms and conditions. This is a requirement which may undermine the effectiveness of the technical cooperation provision as it places the onus on the developing countries to seek assistance. While the provision that developed economies are to provide technical assistance upon request may have been developed to prevent infringement of sovereign rights, it puts the developing states in the position of the debtor as assistance is likely to come at a price determined by developed states, who maintain the balance of power within the relationship. Given that technical assistance has a price, it might be that developing states, especially least-developed states, will be reluctant to seek assistance. While technical assistance is available to developing economies, the method of procuring such assistance may prevent states from seeking assistance. Differentiation, within this context, does not therefore result in efficient outcomes.

The cost of technical assistance also raises the issue of power abuse. Developing economies are generally less organised or technically proficient than their developed country counterparts. In terms of the developing economies being able to implement the TRIPS Agreement in a manner which is beneficial to themselves and other Member states, it is doubtful whether many developing economies are able to manage without assistance from the developed states. The TRIPS Agreement highlights the problems experienced by developing economies with regard to infrastructure. While it recognises that developing countries need technical assistance, it does not address the power issues. It also places the achievement of adequate assistance upon the outcome of bilateral negotiation. Within this context, it is unlikely that many developing economies will be able to hold their own. Bilateral negotiations may therefore benefit the developed economies at the expense of legitimate developing concerns. While higher protection of intellectual property is a right of innovators, the TRIPS Agreement is more likely to benefit developed economies and their TNCs than consumers in developing countries. The Agreement therefore favours developed country interests.

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69 WTO, op cit note 1 at 399.

Linking assistance to mutually-agreed terms and conditions enables the developed states to maintain the balance of power. Any assistance provided is likely to come at the expense of developing country interests, as developing states will have to make some trading concession in order to receive aid. The provision on technical assistance therefore does not provide avenues for redress as it does not place a positive obligation on developed economies to assist their developing country counterparts, nor does it address present inequalities between developed and developing economies. It provides, instead, avenues for developed economies to pursue their own agendas further, especially where least-developed economies are ignorant of their rights, for example protection of their indigenous resources.

The need to prevent abuse must go beyond implementation, however. While the TRIPS Agreement addresses developed country concerns, it does not address reasons for infringement of intellectual property rights by developing economies, where these countries are not merely being opportunistic. Imitation by developing economies is likely to be the result of insufficient technology or access to technology and knowhow, or lack of financial resources on the part of government and the private sector, and lack of skilled labour to establish institutions for research and development. Article 66(2) of the TRIPS Agreement places an obligation on developed country Members to provide incentives to enterprises in the territories for the purposes of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base.[70] This provision provides the only reference to developing country problems. While developed states are obliged to encourage their enterprises to assist least-developed states through incentives, there is no guarantee that least-developed countries will receive the transfer of technology which they require because the provision does not place a positive obligation on developed states to ensure that their enterprises and institutions actually comply. In addition to being open-ended, the provision is toothless and does not guarantee actual redress. Another shortcoming of the Agreement is that it does not address the technological shortcomings of developing economies other than those of the least-developed economies. Given that the difference between the GDP *per capita*[71] of least-developed economies and low income economies as a whole is $1, the lack of focus on the interests of all

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70 WTO, op cit note 1 at 399.

71 Based on World Bank classification criteria.

developing economies cannot be justified legally or economically.

While the TRIPS Agreement appears to differentiate between developed and developing economies, this differentiation is merely superficial as it does not ensure economically or legally efficient outcomes nor does it address the balance of power which is skewed in favour of developed economies. On the issue of power, the TRIPS Agreement neither seeks to eliminate existing inequalities between developed and developing economies nor to provide redress by addressing the needs of the developing economies through legislation or placing a positive obligation on developed states to assist developing economies reach their economic and developmental goals.

8.6 Conclusion

The focus of the TRIPS Agreement cannot be faulted as the rights of innovators must be recognised and protected. Given that intellectual property rights are legal rights which must be protected, developing countries cannot claim to have a right to imitate. Developing countries are, however, entitled to assistance in the implementation of intellectual property laws which may not benefit their domestic industries, but rather the TNCs which operate within their borders. This makes it more difficult for domestic industries to survive in sectors which require ready access to government funding and large capital inflows, for examples, pharmaceutical, medical and other industries which depend on advanced technology. The TRIPS Agreement does not address developing country concerns or make provision for the efficient and effective resolution of these concerns, nor does it address the power issues which contribute towards the circumstances which prevent developing countries from reaching their development and growth objectives. Because the TRIPS Agreement does not adequately address developing country concerns or contribute positively towards the resolution of their infrastructural and technological shortcomings, it discriminates unfairly against developing economies.

Chapter 9

The General Agreement on Trade in Services (GATS)

9.1 Introduction

The General Agreement on Trade in Services constitutes a separate part of the GATT 1994 as trade in goods and trade in services are catered for separately. Unlike trade in goods, which has been regulated by the GATT since its inception, the regulation of trade in services is a new occurrence, which Members are approaching cautiously. The GATS is only the first step in the process of liberalising services and merely provides a foundation upon which subsequent liberalisation may be based. Because of the nature of the GATS Agreement, not much has been asked of the developing economies. Despite this fact, the liberalisation of services globally will affect developing economies. The focus of this chapter is on whether the GATS Agreement discriminates unfairly against developing countries.

9.2 The General Agreement on Trade in Services (GATS)

Because of the general make-up of services, the General Agreement on Trade in Services (GATS) had to be provided for separately from the general GATT provisions. Services have, until recently, been considered as non-tradeables by trade economists. While manufactured products, raw materials and agricultural products are identified as tradeable goods, non-tradeables are primarily services and the output of the construction industry. The main distinguishing feature of trade in services is the fact that it involves different modes of supply than trade in goods. Bhagwati, Sampson and Sapir[1] have divided services into two categories: those which require physical proximity between consumers and suppliers and those which do not. Trade in services which do require physical proximity between consumers and suppliers involves international movement of either consumers or suppliers.[2]

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1 Sapir (1999:52).

2 Loc cit.

9.2.1 Scope and definition

Article 1(2) of GATS defines trade in services as the supply of services:[3]

a) from the territory of one Member into the territory of any other Member;

b) in the territory of one Member to the service consumer of any other Member;

c) by the service supplier of one Member, through commercial presence in the territory of any other Member;

d) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member.

Provisions (a) to (d) of Article 1(2) of GATS can also be defined as cross-border transactions similar to trade in goods, transactions involving consumption abroad, including the international movement of consumers, transactions requiring the establishment of a commercial presence by a foreign supplier and transactions requiring the temporary movement of a supplier who is a natural person.[4] The cross-border supply of services relies on a telecommunication link or postal services. In some cases the service is embodied in an article, for example, software on a computer diskette. Consumption abroad includes repairs of vessels undertaken abroad, and the purchase by tourists of special services, including hotels, restaurants, photographic services, sightseeing packages, massage parlours and sex workers. The commercial presence of service providers covers both the capital flows that make such presence possible and the activities of foreign service suppliers.

The establishment of a commercial presence in a foreign country provides foreign firms with a means of contesting domestic markets. It is this category of foreign service provider which is involved in foreign direct investment (FDI) and is expected to transfer technology and knowledge as well as much

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3 WTO (1995:328).

4 Sapir, op cit note 1. The distinction between a natural and juridical person is important to GATS. Article XXVIII(j) defines persons as either natural or juridical, Article XXVIII(k) states that a natural person of another Member is a natural person who resides in the territory of any other Member, and who is a national of the other Member or has a right of permanent residence in that other Member state. A juridical person is any legal entity only constituted or otherwise organised under applicable law, whether for profit or otherwise, and whether privately owned or governmentally owned, including any corporation, trust, partnership, joint venture, sole proprietorship or association (Article XXVIII(1), WTO, op cit note 3 at 350).

needed capital to host countries. Services requiring the presence of natural persons include medicine and banking.[5] Because many services are not tradeable, cross-border, long-distance exchange or temporary physical movement of either provider or consumer does not suffice for an exchange to be feasible. Firms are only able to sell their services in foreign markets by establishing a long-term physical presence. From the early 1990s, about 50 percent of global FDI flows involved service activities. Once established, foreign firms are considered to be residents of the host country.[6] While global trade in services is dominated by OECD countries, many developing countries are relatively specialised in exporting services. Small developing countries in particular[7] are highly specialised in exports of services. This, in most instances, reflects the importance of tourism and transportation services. On the other hand, developing economies have also become large exporters of transactions processing and related back-office services or information and software development services. Countries involved in these activities include Jamaica and India.[8] For the purposes of GATS, services apply to any sector except services supplied in the exercise of government authority.[9] The supply of a service is deemed to include its production, distribution, marketing, sale and delivery.[10]

Trade in services has two other distinctive characteristics which relate to the industrial organisation of services activities. Because of informational imperfections about the characteristics of services at the time of purchase, many service markets are inherently imperfectly competitive. Some service activities also operate under increasing returns to scale due to a limited supply of producers. Secondly a big difference between trade in goods and trade in services is the issue of deregulation. Despite the ongoing movement towards deregulation of trade in goods, service markets are very highly regulated. This is partly due to their key role in domestic markets, such as in the case of financial services, and

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5 Chang and Koresentry (1999:93).

6 Hoekman and Kostecki (2001:239).

7 Defined as having less than one million people.

8 Hoekman and Kostecki, op cit note 6 at 240-1.

9 Article 1(3), WTO, op cit note 3 at 328. Services supplied in the exercise of governmental authority are those services supplied neither on a commercial basis nor in competition with one or more service suppliers.

10 Article XXVIII (b), WTO, op cit note 3 at 348.

because of their imperfectly competitive structure. Despite the fact that regulation of service activities is usually for domestic purposes, it almost always creates a powerful trade barrier. Trade in services is affected by these and other non-tariff barriers. Tariff protection does not occur.[11]

Non-tariff barriers specific to trade in services can be classified into seven groups: fiscal measures, credit measures, market reservations, capital and labour restrictions, technical standards, administrative regulations and others comprising barriers not covered elsewhere. The major fiscal measures are export subsidies, variable import levies, tariff quotas, anti-dumping duties and tax rebates. Credit measures providing non-tariff barriers include loans and interest rates on concessional terms provided to service industries and service suppliers. Market reservations include quantitative restrictions, export restraints, quotas, government procurement regulations and state trading. Capital restrictions may be placed on the movement of both foreign and domestic capital in the area of trade in services. An example is the denial of entry of foreign companies and capital in the field of insurance services. Labour restrictions, similarly, relate to the movement of labour in the area of trade in services. An example would be the employment of nationals alone in the construction industry. Technical standards or barriers take the form of health and safety standards as applied to services. An example in the shipping industry would be restriction on the movement of containers to routes which hinder free flow of trade. The nature of administrative regulations themselves can act as barriers to trade. Other barriers include research and development expenditure, with grants to support infrastructure for a particular service, expenditure on training etc acting as indirect barriers to exports from other countries.[12]

9.2.2 Competition and domestic regulation

GATS contains provisions dealing with competition issues and domestic regulation. Competition issues are referred to in Articles VIII and IX of GATS. Article VIII deals with monopolies and exclusive service suppliers. Members must ensure that any monopoly service supplier within their

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11 Sapir, op cit note 1.

12 Mukherjee (1995:58-62).

territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with their MFN treatment obligations under Article II and specific commitments.[13] Article II of GATS deals with most-favoured-nation treatment. With respect to any measure covered by GATS, each Member must extend immediately and unconditionally, treatment no less favourable to the services or service suppliers of any other Member, than it extends to like services and service suppliers of any other country.[14] A Member may maintain a measure inconsistent with Article II(1) provided this measure is listed in, and meets the conditions of the Annex on Article II Exemptions.[15] The MFN provision applies to all Members except for listed exceptions such as regional blocs. This is known as a negative list because the provision applies except where stated explicitly. MFN exemptions are, in principle, to last for no longer than 10 years and are subject to negotiation in future multilateral rounds. The need for an annexure on MFN exceptions arose from concerns which some Member states had that an unconditional MFN rule would allow competitors who are located in relatively protected countries to benefit from their sheltered markets while enjoying a free ride in less restrictive export markets.[16]

National treatment is subject to a positive list. Only sectors listed receive it. Even this is conditional, however, because certain sectors can be completely exempted from liberalisation. These exemptions can be far-reaching. An example is the economic needs test which permits imports only where no domestic supplier exists. National treatment applied to foreign service providers may or may not be identical to that applying to domestic firms. Such differentiation between domestic and foreign firms is based upon recognition that identical treatment may actually worsen the conditions of competition for foreign based firms. As example is a requirement for insurance firms that reserves be held locally.[17]

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13 Article VIII (1), WTO, op cit note 3 at 335.

14 Article II (1), WTO, op cit note 3 at 329.

15 Article II (2), WTO, op cit note 14 at 329. See WTO, op cit note 3 at 352.

16 Hoekman and Kostecki, op cit note 6 at 252.

17 Hoekman and Kostecki, op cit note 6 at 253.

Members can also make market access commitments which are based on a positive list to define the sectors to which they apply. Only listed sectors are subject to market access commitments. For these sectors, certain restrictions are prohibited unless they have been explicitly listed in a country's Uruguay Round schedule. These include restrictions on the number of suppliers, the total value of transactions or assets, the total quantity of services or service operations, the number of natural persons employed, the type of legal entity permitted and the participation of foreign capital. Other restrictions on market access are not directly controlled. Most are controlled through the national treatment provision, however, as they fall foul of this provision. Only in sectors which are not scheduled for national treatment are trade restrictions more prevalent.[18] The introduction of market access commitments in the GATS reflects the fact that the contestability of service markets is frequently restricted by measures that apply to both foreign and domestic firms. The market access provision explicitly covers some of the measures which were felt to be of particular importance. This provision may be equated with the GATT Article XI which prohibits the use of quotas. In practice, however, the market access obligation overlaps with the national treatment requirement, as prohibited market access restricting measures may also violate national treatment.[19]

The provisions of GATS must not be interpreted in a manner which prevents any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.[20] Where a Member's monopoly supplier competes, directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights, the Member shall, if the service is subject to its specific commitments, ensure that its monopoly supplier does not abuse its monopoly position and act in a manner inconsistent with the Member's commitments.[21] The provisions of Article VIII apply

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18 McCulloch, Winters and Cirera (2002:236).

19 Hoekman and Kostecki, op cit note 6 at 253. See also Hoekman (1995:333-35).

20 Article II (3), WTO, op cit note 14. This provision refers to areas which touch along the boundaries of adjacent countries which may serve as zones for service industries which serve both countries. The term contiguous zone is based upon the contiguous zone referred to in the Geneva Convention on the Territorial Sea and the Contiguous Zone, 1958 (see Harris 1983:331-34).

21 Article VIII (2), WTO, op cit note 3 at 336.

also to cases of exclusive service suppliers where a Member formally or in effect authorises or establishes a small number of service suppliers and substantially prevents competition among those suppliers in its territory.[22] Basically, monopoly or oligopoly supply of services is allowed under GATS. Governments must, however, ensure that firms granted exclusive rights do not abuse their market power to nullify any specific commitments relating to activities which fall outside of the scope of their exclusive rights.[23]

On the issue of business practices, Article IX (1) requires that Members recognise that certain business practices of service suppliers, other than those falling under Article VIII, may restrain competition and thereby restrict trade in services.[24] At the request of any other Member, each Member must enter into consultations with a view to eliminating trade restricting business practices. The Member addressed must give full and sympathetic consideration to such a request and must cooperate through the supply of publically available non-confidential information relevant to the matter in question. The Member addressed must also provide other information available to the requesting Member, subject to its domestic law and the conclusion of satisfactory agreement concerning the safeguarding of its confidentiality by the requesting Member.[25]

GATS has two provisions relating to domestic regulation. Article III deals with transparency and Article VI with domestic regulation. The Preamble to GATS recognises the right of Members to regulate, and to introduce new regulations on the supply of services within their territories in order to meet national policy objectives. Given the asymmetries existing with respect to the degree of development of service regulations in different countries, the Preamble recognises the particular need of developing countries to exercise this right. Article III (1) of GATS requires each Member to publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application pertaining to or affecting the operation of the Agreement.

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22 Article VIII (5), WTO, op cit note 3 at 336.

23 Hoekman and Kosecki, op cit note 6 at 254.

24 Article IX (1) WTO, op cit note 3 at 328.

25 Article IX (2), WTO, op cit note 24. See also Sapir, WTO, op cit note 1 at 54.

International agreements pertaining to or affecting trade in services to which a Member is a signatory shall also be published.[26] Where it is not practicable to publish measures referred to in Article III (1), such information must be made otherwise publically available.[27]

Nothing in the GATS Agreement requires any Member to provide confidential information, where the disclosure of this information will impede law enforcement, or otherwise be contrary to public interest or will prejudice legitimate commercial interests of particular enterprises, public or private.[28] On the matter of domestic regulation, Article VI (1) requires each Member, in sectors where specific commitments are undertaken, to ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. Members are required to maintain or institute as soon as practicable judicial, arbitral or administrative tribunals or procedures which provide, at the request of an affected service supplier, for the prompt review of, and where justified, appropriate remedies for administrative decisions affecting trade in services. Where these procedures are not independent of the agency entrusted with the administrative decision concerned, the Member must make certain that the procedures actually do provide for an impartial and objective review.[29] According to Hoekman and Kostecki, going beyond an information exchange obligation is not feasible, given the regulatory diversity prevailing across Members in the area of competition policy.

In many developing countries, the coverage of specific commitments is well below 25 percent of all services, and modes of supply. Hoekman is of the opinion that binding the *status quo* will reduce uncertainty and that pre-committing to future reform could help increase the relevance of the GATS. There is, however an important political dimension to services liberalisation. Because services cannot be traded, increasing access to domestic service markets is likely to require the entry of foreign competitors through FDI. This will not only result in the introduction of new technologies but also

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26 WTO, op cit note 3 at 329.

27 Article III (2), WTO, op cit note 26.

28 Article III bis, WTO, op cit note 3 at 330.

29 Article VI (2)(a), WTO, op cit note 3 at 333.

entail demand for domestic labour. This is an outcome which does not necessarily occur with merchandise liberalisation. Foreign telecommunications or electricity operators, banks or retailers all need domestic labour. While liberalisation, and consequently increased foreign entry, will inevitably result in the restructuring of domestic industry, the reform of services has less far-reaching implications for sectoral turnover and aggregate employment than the abolition of trade barriers for merchandise.[30]

Services reform may also have a large payoff by facilitating liberalisation of trade in goods. The liberalisation of trade in goods will result in contraction or adjustment of domestic industries that benefit from protection, while industries in which the country has a comparative advantage will expand. Often it is not known beforehand which sectors and activities will become growth areas, resulting in a lag between those who will lose and those who will gain from liberalisation. This makes the early transition process politically difficult. Hoekman suggests that political constraints to trade liberalisation may be relaxed by reforms targeting the service sectors. Pro-competitive reforms which facilitate entry by new firms can generate employment opportunities for both skilled and unskilled employees of government or import-competing manufacturing sectors, or those who are unemployed. A political precondition for public sector downsizing is likely to be a perception that alternative employment opportunities will be created. The small scale private sector must play a major role in this process. Participation of the small scale private sector is dependent upon market contestability. From a political economy perspective it is important that industries that use services as inputs will all gain from measures that reduce service costs and increase their quality and variety. Agricultural and manufactures producers should therefore support service sector reforms.[31]

Hoekman states that this is important, as services liberalisation efforts rely less on reciprocal, market access-based negotiations. Reciprocal opening of markets play less of a role in services because little support for reform can be expected to emerge from potential exporters of services and because non-border protection is dominant. In many developing countries opposition to services reform and

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30 Hoekman (2002:13-14).

31 Hoekman, op cit note 30 at 14.

liberalisation cannot be counterbalanced by export interests seeking better access to foreign service markets. Trade negotiations do not therefore have equivalent focal points and necessary information to negotiate in a manner which guarantees welfare-improving outcomes. At issue in the services context are generally regulatory regimes which cannot and should not be altered in incremental ways. The onus will therefore be on identifying reforms that are in the national interest. This is a process which must be undertaken and led by central decision makers.[32]

The Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines which ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. These disciplines will aim to ensure that such requirements are, amongst other things, "based on objective and transparent criteria, such as competence and the ability to supply the service, not more burdensome than necessary to ensure the equality of the service, and in the case of licensing procedures, not in themselves a restriction on the supply of the service."[33] In sectors where Members have undertaken specific commitments, pending the entry into force of disciplines developed in those sectors in accordance with Article VI (4), Members may not apply licencing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which does not comply with the criteria prescribed in subparagraphs 4(a), (b) or (c) and could not reasonably have been expected of these Members at the time the specific commitments in these sectors were made.[34] In the *Bananas*[35] case the complainants argued that the method of distributing import licences violated the GATS because ACP bananas were largely distributed by EU-based entities. The EU argued that a number of non-EU distributors were allocated quotas for these bananas and that there was no violation of national treatment in distribution. The Panel focused not on the nationality of providers but on the question of allocation of licences. It recognised that the operator category rules apply to service suppliers regardless of their nationality, ownership or control.

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32 Loc cit

33 Article VI (4), WTO, op cit note 29.

34 Article VI (5)(a), WTO, op cit note 3 at 334.

35 WT/DS27/AB/R, 12 February 1996, para 7.324.

The allocation scheme nevertheless affected the conditions of competition. The focus was therefore on outcomes, that is, the market share held by EU firms and not on discrimination *per se*.

When determining whether Members have conformed with their obligations under paragraph 5(a), account will be taken of international standards of relevant organisations applied by Members.[36] In sectors where specific commitments regarding professional services have been undertaken, Members shall provide for adequate procedures to verify the competence of professionals of other Members.[37] On the issue of transparency, Hoekman states that the scheduling technology used in the GATS does not greatly promote transparency. There is a fundamental need to improve the available information on *status quo* policies, as this will facilitate national reform efforts and help identify where the multilateral process can support such efforts. There is nothing within the GATS which encourages and assists countries in generating comprehensive information on policies and evaluating the impact of these policies. While the Trade Policy Review Mechanism is a step in the right direction, more has to be done. Hoekman suggests that priority should be given to greatly improving statistics and data on trade barriers and entry-cum-operating restrictions in services. The importance of strengthening capacity to collect and analyse information should not be overemphasised. Better information on status quo policies, their effects and the impact of GATS-based liberalisation agreements will help governments with policy making and provide business and civil society with the information needed to engage in the domestic policy formation process. Hoekman proposes that there should be negative list reporting of prevailing policies in services for transparency purposes. This should be accompanied by adequate technical and financial assistance to help developing countries, especially least developed countries, participate in the transparency exercise.[38]

On the issue of imperfect competition, the GATS differs from the GATT. While Article IX (1) refers to the restrictive business practices of service suppliers which restrain competition and restrict trade

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36 Article VI (5) (b), WTO, op cit note 34. Footnote 3 of GATS states that the term "relevant international organisation" refers to international bodies whose membership is open to the relevant bodies of at least all Members of the WTO.

37 Article VI (6), WTO, op cit note 34.

38 Hoekman and Kostecki, op cit note 6 at 271.

in services, Article IX (2) does not provide for the elimination of these measures, as is typical of GATT provisions. Members are merely required to enter into discussions with a view to eliminating these practices.[39] Rather than provide for the multilateral removal of restrictive business practices relating to services, and disregarding the economics of such a move, GATS has provided a more flexible method for the elimination of such practices. This approach provides developing countries with greater flexibility to mould their competition rules in a manner necessary to promote growth and development in their economies. The developed economies are, however, able to maintain their trade distorting business practices until such a time as they are challenged by other Member states to do so. Within the multilateral framework, the GATS, like Article 19 of the Paris Convention of 1967, which has been adopted by the TRIMS Agreement, makes provision for bilateral negotiations amongst Members. Article V, which deals with economic integration, does not prevent Members from being party to or entering into agreements liberalising trade in services between or among the parties to such an agreement. Such an agreement[40] must, however, "have substantial sectoral coverage[41] and provide for the absence or elimination of substantially all discrimination, in the sense of Article XVII,[42] between or among the parties, in the sectors covered under subparagraph (a) through the elimination of existing discriminatory measures, and/or prohibition of new or more discriminatory measures. The elimination of discrimination must occur at the entry into force of that agreement or on the basis of a reasonable time-frame, except for measures permitted under Articles XI, XII, XIV and XIV bis."[43]

Where developing countries are parties to an agreement of the type referred to in paragraph 1 of Article V of GATS, flexibility must be provided for regarding the conditions set out in paragraph 1, particularly with reference to subparagraph (b) thereof. The flexibility accorded to developing

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39 Sapir, op cit note 1 at 55.

40 Article V (1), WTO, op cit note 3 at 331.

41 Footnote 1 of GATS states that this condition is understood in terms of the number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* including reasoning from cause to effect] exclusion of any mode of supply.

42 Article XVII refers to the national treatment clause of GATS.

43 These articles refer to payments and transfers, restrictions to safeguard the balance of payments, general exceptions and security exceptions, respectively.

countries is dependent on the level of development of the countries concerned, both overall and in individual sectors and subsectors.[44] Not withstanding paragraph 1 involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.[45] Paragraph 6 states that a service supplier of any other Member that is a juridical person under the laws of a party to a paragraph 1 agreement is entitled to treatment granted under such agreement, provided that the juridical person engages in substantive business operations in the territory of the parties to such agreement. On the issue of bilateralism, Mukherjee[46] states that the diverse nature of bilateral agreements and arrangements necessarily induces a large dose of heterogeneity directly or indirectly which is endorsed by the GATT Uruguay Round in its realistic tuning to world trade affairs. This promotes realism but also increases variability, which is often difficult to manage and may give rise to various conflicting situations which are difficult to handle. It also reduces the scope of multilateralism in world trade. The issue of bilateralism versus multilateralism is very important to developing countries as multilateral negotiations level the negotiating field in a way which bilateral negotiations do not, especially when developing countries face their developed country counterparts in a bilateral negotiating setting. Bilateralism strips less powerful states of the support which would be available to them at a multilateral level, making these states more vulnerable to coercion from powerful states. Even with the call for flexibility to be provided to developing countries, these countries may still be forced to concede more than they actually should. Despite the emphasis of the GATS on the need for flexibility for developing and developed countries, such considerations are more likely to be achieved when negotiations are made within the multilateral framework. During bilateral negotiations, even though developed countries may be obliged to provide special treatment to developing and least-developed economies, these requirements may constitute a small portion of negotiations. Bilateral negotiations also rob developing economies of their ability to make concessions only where they receive concessions from other Members on issues of interest to them. It would be in the interest of developing countries if parameters are placed on bilateral negotiations.

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44 Article V(3)(a), WTO, op cit note 3 at 331.

45 Article V(3)(b), WTO, op cit note 44.

46 Mukherjee, op cit note 12 at 19.

On the issue of domestic regulation, Sapir[47] refers to the sectoral division of services within the GATS. He states that whereas GATT Member states make concessions about products, the GATS Members make commitments about sectors. Whereas the GATT negotiations are usually conducted by trade officials with no special interest in particular products, the GATS negotiations are conducted by trade officials and officials involved in regulating particular sectors.[48] The danger of protectionist capture by vested interest groups is greater in the case of services than with goods. The control rate of sectors in the GATS is also evident from the reference of the Annexes to specific sectors. These are air transport services, financial services, maritime transport services and telecommunications. Trade economists and lawyers generally view the sectoral approach as providing a shield from liberalisation to politically powerful sectors, as has been the case for agriculture and textiles in the GATT context. The recent elimination of all duties on informational technology products shows that the sectoral approach can work in certain circumstances. Sapir states that another factor contributing to the bias towards sectoral negotiations in services is the absence of tariffs and of tariff-equivalents for trade barriers. This situation makes it almost impossible to apply the principle of reciprocity which is used in the GATT negotiations to the GATS context.[49]

9.2.3 Developing economies and liberalisation in services

The GATS makes continuous mention of the developing countries and the difficulties which they face in the services context. The Preamble to the GATS Agreement recognises the need to facilitate the increasing participation of developing countries, and the expansion of their service exports including, *inter alia*, through the strengthening of their domestic services capacity and its efficiency and competitiveness. Members have also taken into account the serious difficulty of the least-developed

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47 Sapir, op cit note1at 56.

48 Article VII (5) provides that, wherever appropriate, recognition should be based on multilaterally agreed criteria. In appropriate cases, Members may work in cooperation with relevant intergovernmental and non-governmental organisations towards the establishment and adoption of common international standards and criteria for recognition. The Annex on Financial Services, paragraph 4 provides for disputes on prudential issues and other financial matters to have the necessary expertise relevant to the specific financial service under dispute (WTO, op cit note 3 at 356).

49 Loc cit.

countries in view of their special economic situation and their trade and development needs. Article IV of the GATS deals with increasing participation of developing country Members in world trade. Increased participation will be facilitated through negotiating specific commitments, relating to the strengthening of their domestic services capacity, efficiency and competitiveness, *inter alia*, through access to technology on a commercial basis, improving their access to distribution channels and information networks, and liberalisation of market access in sectors and modes of supply of export interest to them.[50]

Developed country Members, and where possible other Members, must establish contact points within two years from the date of entry into force of the WTO Agreement to facilitate the access of developing country Members' service supplies to information related to their respective markets. These contact points will include commercial and technical aspects of the supply of services, registration, recognition and obtaining of professional qualifications, and the availability of services technology.[51] Priority is to be given to least-developed country Members in the implementation of paragraphs 1 and 2 of Article IV of GATS.[52]

While emergency safeguard measures apply to all Member states, these measures will provide developing country Members with greater flexibility. Article X (1)[53] provides that there shall be multilateral negotiations on the question of emergency safeguard measures based on the principle of non-discrimination. The results of these negotiations will come into effect on a date no later than three years from the date of entry into force of the WTO Agreement. Article XII on restrictions to safeguard the balance of payments also provides Members with the flexibility necessary to regulate domestic measures. Article XII(1) states that in the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions

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50 Article IV (1), WTO, op cit note 3 at 330.

51 Article IV (1), WTO, op cit note 3 at 330.

52 Article IV (3), WTO, op cit note 51.

53 WTO, op cit note 3 at 336.

related to such commitments. Members recognise that particular pressures on the balance of payments of a Member in the process of economic development or economic transition may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition. In determining the incidence of such restrictions, Members may give priority to the supply of services which are more essential to their economic or development programmes. These restrictions may not be adopted or maintained for the purpose of protecting a particular service sector.[54]

The issue of government procurement measures has been of great importance to developing country governments who are against the liberalisation of these measures. Article XIII(1) provides that Articles II, XVI and XVII shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale.[55] Articles II, XVI and XVII refer to most-favoured-nation, market access and national treatment provisions respectively. Article XVI (1) provides for Members to accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule. This provision applies to market access through the modes of supply identified in Article 1.[56] Article XVIII provides that in sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, Members shall extend to the services and service providers of other Members, in respect of all measures affecting the supply of services, treatment no less favourable than that which it extends to its own like services and service suppliers.[57] Formally identical or formally different treatment will be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services of service suppliers of any other Member.[58] The removal of Articles II, XVI and XVII from the application of government procurement

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54 Article XII (3), WTO, op cit note 3 at 338.

55 WTO, op cit note 3 at 339.

56 WTO, op cit note 3 at 341.

57 WTO, op cit note 3 at 342.

58 Article XVIII (3), WTO, op cit note 3 at 343.

measures effectively eliminates these measures from the scope of the GATS.

On the issue of subsidies, Members have agreed to enter into negotiations with a view to developing the necessary multilateral disciplines to avoid the trade-distorting effects of subsidies. The negotiations will also address the appropriateness of countervailing measures. These negotiations will take into account the role of subsidies in the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For purposes of these negotiations, Members must exchange information concerning all subsidies related to trade in services that are available to their domestic service suppliers.[59] In order to achieve the objectives of GATS, Members were to enter into successive rounds of negotiations no later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalisation. These negotiations are to be directed at the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. Negotiations will take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.[60] The liberalisation process shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalising fewer types of transaction progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching conditions to such access aimed at achieving the objectives referred to in Article IV.[61] The GATS also provides for technical assistance to be provided to developing countries at a multilateral level by the Secretariat and decided upon by the Council for Trade in Services.[62]

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59 Article XV (1), WTO, op cit note 3 at 341.

60 Article XIX (1), WTO, op cit note 3 at 343.

61 Article XIX (2), WTO, op cit note 60. Article IV deals with the progressive integration of developing countries.

62 Article XXV (2), WTO, op cit note 3 at 347.

9.2.4 Financial services and telecommunications

Article 2 of the Annex on Financial Services provides that a Member will not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where these measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Members' commitments or obligations under the Agreement.[63] A Member may recognise prudential measures of any other country in determining how the Members' measures relating to financial services are to be applied. This recognition may be based on an agreement or arrangement with the country concerned or may be accorded autonomously.[64] Regarding access to and use of public telecommunications, transport networks and services each Member must ensure that any service supplier of any other Member is given access to and the use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule. This obligation shall be applied, *inter alia*, through paragraphs (b) to (f).[65] Notwithstanding the provisions of paragraphs (b) through (f), developing country Members may, consistent with their level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen their domestic telecommunications infrastructure and service capacity and to increase their participation in international trade in telecommunications services. Such conditions shall be specified in the Members' Schedule.[66]

While the Protocol on Financial Services provides for a fair amount of liberalisation, the direct welfare gains for the citizens of developing economies are negligible. According to McCulloch *et al*, liberalisation of financial services does have indirect effects on developing country consumers. Cheap

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63 Article 2 (a), Annex on Financial Services, GATS, WTO, op cit note 3 at 355.

64 Article 3 (a), Annex on Financial Services, GATS, WTO, op cit note 3 at 356.

65 Article 5 (a), Annex on Telecommunications, WTO, op cit note 3 at 361.

66 Article 5 (g), Annex on Telecommunications, WTO, op cit note 3 at 362.

and effective financial services, including payment mechanisms, raise the competitiveness of existing firms and facilitate new transactions and opportunities. Increased liberalisation is linked, however, to concern about monopoly power of multinational companies operating in the financial services sector in developing countries. This is an outcome which must be guarded against. Developing country consumers are often the victims of local financial institutions that are both monopolistic and inefficient. Increased competition, in these circumstances, will most likely benefit consumers. Governments are not constrained from imposing universal service requirements which protect the consumer, so long as these provisions satisfy national treatment. McCulloch *et al* emphasise the importance of sound regulatory structures and macro policies being in place prior to financial liberalisation . Nothing within the GATS Protocol on Financial Services constrains sound prudential regulation.[67]

On the issue of technical cooperation, Members recognise that an efficient, advanced telecommunications infrastructure in countries, particularly developing countries, is essential to the expansion of their trade in services. To this end, Members approve of and encourage the participation, to the fullest extent practicable, of developed and developing countries and their suppliers of public telecommunications transport networks and services and other entities in the development programmes of international and regional organisations. These include the International Telecommunication Union, the United Nations Development Programme, and the International Bank for Reconstruction and Development.[68] Members shall encourage and support telecommunications cooperation among developing countries at the international, regional and sub-regional levels.[69] In cooperation with relevant international organisations, Members must make available to developing countries, where practicable, information with respect to telecommunications services and developments in telecommunications and information technology to assist in strengthening their domestic telecommunications services sector.[70] Members are also to give special consideration to

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67 McCulloch *et al*, op cit note 18 at 246-7.

68 Article 6 (a), Annex on Telecommunications, GATS, WTO, op cit note 3 at 367.

69 Article 6 (b), WTO, op cit note 68.

70 Article 6 (c),WTO, op cit note 68.

opportunities for the least-developed countries to encourage foreign suppliers of telecommunications services to assist in the transfer of technology, training and other activities that support the development of their telecommunications infrastructure and expansion of their telecommunications services trade.[71]

The GATS provides for the exemption of government procurement measures, but generally expects all Members to extend most-favoured nation treatment and national treatment to all specified sectors, including financial services and telecommunications. No parties to the Agreement are exempt, although developing and least-developed countries could choose to liberate fewer sectors than the developed countries. Unlike most provisions on trade in goods, countries can choose the pace of liberalisation for their services sectors, based on their level of economic growth and development. While GATS recognises that regulations for trade in services may be trade-distorting, there are no actual provisions prohibiting specific regulating measures. Members may consult with other Members bilaterally where these provisions are directly trade-restrictive and affect their service providers.

9.2.5 Implications for developing economies

The GATS does not discriminate between capital-intensive trade in services as found in most developed countries and labour-intensive trade in services as found primarily in developing countries. Little progress was made in liberalising the movement of natural persons in the Uruguay Round. Agreement has been made, through regional arrangements like the NAFTA and the EU's Europe Agreements with East and Central European countries, on the movement of highly skilled workers. McCulloch *et al* are of the opinion that the mobility of highly skilled workers is of very little benefit to developing countries.[72] The mobility of unskilled workers is of much greater interest to developing economies, as unskilled workers provide developing economies with their greatest comparative advantage. According to McCulloch *et al,* the movement of low and medium skilled workers is a

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71 Article 6 (d), WTO, op cit note 68.

72 McCulloch *et al*, op cit note 18 at 244.

more secure means of improving welfare in developing economies through general income growth and poverty alleviation. Achieving this outcome is likely to be formidable because of the practical issues involved, such as health cover for migrants as well as the concerns that unskilled workers would lack rights in their host countries. Unskilled workers in the developed economies are also likely to campaign fiercely against such mobility of unskilled developing country workers.[73] Chanda[74] cites eligibility requirements for cross border movement of natural persons as a restricting factor against cross border mobility of developing country workers. He states that eligibility conditions tend to be biased against middle and lower level professionals with respect to wages, prior employment and investment in most developed countries. This occurs because higher level managerial staff are seen as raising competitiveness without significant displacement effects in the local labour market while entry by middle level persons is likelier to displace local labour. Such biases to entry and conditions are detrimental to developing countries which have a comparative advantage in exporting services via middle level personnel, rather than managerial and executive level personnel, as the latter are generally linked to commercial presence overseas.[75]

Government procurement and sourcing policies are another common source of discrimination against foreign service providers. In many countries governments give procurement preferences to domestic suppliers of services. Such discriminatory regulations and price-based preferences to domestic suppliers are common in areas such as education, data processing and non-medical professional services. Policies which are intended to protect consumers and reduce the scope of professional misconduct and liability, may indirectly restrict cross-border labour flow in services. These include rules on accounting and advertising practices, restrictions on the use of international and foreign firm names, prior residence, permanent residency or domicile requirements and restrictions on the area of practice within a sector. Policies in some sectors, such as law, may also be more liberal towards foreign professionals who share principles and approaches similar to those practised within the host

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73 Loc cit.

74 Chanda (2001:635).

75 Chanda, op cit note 74 at 636.

country.[76] While the movement of natural persons from developing to developed economies will be of benefit to developing economies, there remain many barriers to the export of low to middle level skilled workers to developed countries.

There should technically be no impediments to the transfer of labour-intensive trade in services from developing to developed countries. The GATS provides developing country Members with sufficient flexibility with which to regulate the trade in services within their domestic territories, provided that the regulatory measures adopted are transparent. On the issue of foreign direct investment, while developing countries must provide market access, most-favoured nation and national treatment to specified service sectors, they have retained the right to adopt regulatory measures which target their specific economic and development needs, provided these measures do not conflict with other provisions of the agreement. Developing and least-developed economies can also expect technical assistance from developed countries as a right. Unlike previous GATT Agreements which specify that developed countries may extend assistance to developing economies, Article IV (2) has made the extension of technical assistance by developed countries to developing and least-developed economies a concrete obligation.

On a more negative note, Article VII(1) provides for the bilateral negotiation of standards and criteria for recognition, without providing for basic standards of recognition which are applicable to all Members. The standards acceptable to developing countries relating to education, training, licencing and certification of services suppliers may be too low and therefore unacceptable to developed economies. These differences may provide developed countries with grounds with which to discriminate against developing country service providers. GATS also provides for bilateral negotiations between Members on the issues of economic integration and subsidies. Provision is however made for the need of developing countries to have flexibility in these areas. The adoption of bilateral negotiations as an integral part of the GATS process, while realistic, may provide developed countries with not only the means of indirectly discriminating against developing countries, but also the means to raise standards for trade in services to standards beyond the reach of developing and least-developed countries. The outcome of bilateral negotiations, however, is dependent on the attitude

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[76] Chanda, op cit note 74 at 637-38.

which both developing and developed economies take to the negotiations.

Because the GATS is in its infancy, while developing countries have to open selected service sectors to global competition, the sectors opened are the choice of developing country governments, except for the sectors specified in the Agreement itself. Developing country governments may liberalise their service industries at a pace suitable to their stage of economic development and retain the right to regulate their service industries without the interference of the global community. Developing countries also have the right to seek technical assistance from their developed country counterparts.

9.3 Does the GATS Agreement discriminate unfairly against developing economies?

The GATS Agreement, by its very nature as a founding document, does not require much of both developing and developed economies beyond an initial commitment to the liberalisation of trade in services. Despite the slow beginning to the liberalisation of services, the GATS Agreement is mindful of developing country needs, and distinguishes between the needs of developed and developing economies. While the developed economies are bound by all the relevant GATS provisions, developing and least-developed economies are given more preferential treatment. There is therefore a recognition of differences amongst Member states, with similarly situated states, for example, developed or least-developed groups of states being treated similarly and differently situated states being treated differently.

Given that discrimination does not necessarily amount to unfair treatment, it is necessary to determine the nature of the discrimination. To this end, it must be ascertained whether a rational connection exists between the discrimination and a legitimate WTO goal. Linked to the rational connection test is the proportionality test, that is, whether there is a reasonable relationship between the means employed and the ends sought to be achieved. Discrimination, within the GATS context, occurs in three forms. Firstly, the GATS Agreement provides the developing states with greater flexibility in the implementation of the GATS provisions. With the elimination of trade distorting measures, developing states have much more flexibility than developed states. Developing states are therefore

given leeway regarding the pace of liberalisation within their economies or which sectors they seek to liberalise.

Judicial institutions owned by citizens within developing economies are to be given more favourable treatment. Developing economies are also given greater flexibility in the area of subsidies, given the role of subsidies in relation to the development programmes of their economies. Liberalisation is to occur progressively, with due respect being given to the national policy objectives of individual Member states. Appropriate flexibility is therefore to be given to individual country Members for opening fewer sectors, liberalising fewer types of transactions and progressively extending market access in line with their development situation.

The second form of differentiation occurs through technical cooperation, with technical assistance to developing economies being provided at a multilateral level by the WTO Secretariat. Developed country Members are also obliged to establish contact points within two years from the date of entry into force of the WTO Agreement to facilitate access of developing country service suppliers to information. Lastly, the increased participation of developing country Members is to be sought by strengthening their domestic services capacity and its efficiency and competitiveness through access to technology, improving their access to distribution channels and information networks and liberalising market access in sectors of export interest to them. Least-developed country needs are also to be taken into account, especially the difficulty of the least-developed countries accepting negotiated specific commitments due to their special economic situation and their development, trade and financial needs.

Given the nature of the discrimination, is there a rational connection to a legitimate WTO goal? The GATS Agreement seeks to promote, through discrimination, increased participation of developing countries in trade in services and the expansion of their service exports including, *inter alia*, through strengthening their domestic services capacity and its efficiency and competitiveness. The Agreement also recognises the right of Members to regulate and introduce new regulations on the supply of services within their territories in order to meet national policy objectives. Given the asymmetries which exist with respect to the degree of development of service regulations in different countries,

Members are mindful of the particular need of developing countries to exercise this right.[77]

Discrimination, within the GATS context, takes into account the special needs of developing economies and provides for these needs through flexibility, technical assistance and providing for the needs of service providers in these economies to be met through technical assistance and increased access to information, improved access to distribution channels and liberalisation of market access. The discrimination is in keeping with the goals of the GATS Agreement with respect to developing economies. There is therefore a rational connection between the discrimination and a legitimate WTO goal. On the question of whether there is a reasonable relationship of proportionality between the means employed and the ends sought to be achieved, the answer is yes. Discrimination within this context is linked directly to the goals sought be to be achieved. While the developed economies are obliged to assist the developing economies to develop their service sectors, the duty placed upon these states is neither beyond their capabilities nor does it place burdens upon developed states which they are unable to bear. Development of stable, efficient and competitive service providers within developing states is to the advantage of developed economies, as better infrastructure and service providers within developing economies benefit the TNCs operating within these states. The discrimination is therefore also proportional.

Given that discrimination within the GATS context is both proportional and rational, it needs to be determined whether it is efficient and prevents the abuse of power. Unlike the GATT Agreement which consists of blanket provisions which are ultimately applicable to all states, the GATS promotes progressive liberalisation of various service sectors, with individual countries being responsible for determining the pace of liberalisation of sectors, the extent of liberalisation of market access, reduction of trade distorting measures and implementing the appropriate policies to support and stabilise domestic service providers, such as the financial sector. Within this context, the discrimination is meant to ensure that developing economies liberalise their markets at a pace which is sustainable and conducive to efficient and competitive outcomes. Given that liberalisation is likely to ensure a more efficient service market, discrimination which promotes liberalisation is efficient. In addition to achieving economic efficiency, discrimination should also be legally efficient. This

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77 WTO, op cit note 3 at 327.

means that the discrimination must be linked to obtaining fair outcomes and the elimination of inequalities through redress. Although the GATS places obligations on developed economies to assist developing economies with information registration and obtaining the requisite standards, no mention is made of the problems regarding infrastructure, access to technology and skills and other problems which affect the ability of developing economies to develop their service industries appropriately. Aside from the positive duty for developed states to assist with information, no real room has been made for redress as the developed economies may extend the assistance which they determine to be relevant without being obliged to help the developing economies in ways which will actually benefit these states. With regard to fair equality of opportunity, the GATS Agreement does not go far enough. While it is important that developing economies liberalise at their own pace, the Agreement does not place positive obligations on developed economies to give developing economies preferential access to their markets, although this is an option open to discussion between the two parties.

A shortcoming of the Agreement is that it does not actively promote opportunities for developing country development but leaves any preferential access to bilateral discussions amongst states. While these discussions may enable states to concentrate on the individual needs of the developing economies, it still gives developed economies options on the extent and type of assistance to be extended and the concessions which it seeks in return. Once again, developing economies are reduced to the status of beggar nations. Where developing states have to give up more than they can afford in order to obtain better market access or aid, this cannot be deemed fair. As to the prevention of the abuse of power, it is necessary to determine whether the GATS seeks to eliminate the inequalities which permit such abuse. Within the service market, developing countries are at a vast disadvantage because of the lack of infrastructure within their economies, insufficient and outdated technology, lack of access to appropriate information and technology, and lack of skilled workers. Developed and developing country service providers are at very different places, with service providers within developing economies not being as sophisticated, competitive or professional as their developed country counterparts. Prevention of power abuse within this context will require commitment by the developed states to addressing the problems faced by the developing economies.

Bilateral negotiations are a major means of negotiation between states. Where developing economies negotiate with developed economies bilaterally, the issue of power play is once again an element. While the developed economies can rely on their well established service sectors and the promise of FDI outflows to compliant developing economies, developing economies are limited in terms of negotiating power. As negotiations are largely linked to market power and market access possibilities, the developed economies have much greater negotiating and bargaining power. Without the ability to draw upon multilateral support, developing economies are placed within a position of relative powerlessness.

Apart from the concrete obligation which developed states have to provide developing countries with information, the developed economies are not really bound by obligations which compel them to play a positive role in the development of developing country markets. While developing countries may enter into negotiations with developed states for special and differential treatment, such treatment is likely to come at a cost. The GATS Agreement does not actually provide for redress, with discrimination applying more to implementation of the GATS Agreement. While there is recognition of the special needs of developing economies, the Agreement does not have any concrete measures beyond technical assistance which compel other Members to undertake positive measures to facilitate development. Where a positive obligation is placed on developed economies to place developing country needs before their own, especially the needs of LDCs and lower to lower-middle income developing economies, the power imbalance between developed and developing countries can be shifted, with the developing economies having more power to determine their own futures. This is not an aspect of the GATS Agreement, however, as developed states are at liberty to decide the extent of assistance to be provided to developing economies and the cost of such assistance. The balance of power therefore remains firmly with developed Member states. The GATS Agreement therefore does not address power abuse. While discrimination occurs within the GATS context, it is not focused on the elimination of existing inequalities between developed and developing economies and is therefore unfair.

9.4 Conclusion

The GATS Agreement is a forerunner to future service agreements which seek to promote liberalisation within specific service sectors. Through progressive liberalisation, the GATS Agreement seeks to promote greater efficiency and competitiveness of service providers. Because of the greater problems experienced by the developing states, the GATS Agreement provides for greater flexibility and leeway to be granted to these states, with developed states being called upon to provide appropriate information and to be open to negotiations with developing states which address developing country needs. Aside from the duty to provide information, the Agreement does not place positive duties on developed Member states to assist developing countries through concrete measures which deal specifically with developmental needs. This is a fatal flaw of the GATS Agreement as it does not address the power imbalance, which results from the existing inequalities between developed and developing states. Until these inequalities are addressed and eliminated, the developing economies will remain at the mercy of unscrupulous developed Members. Because the GATS Agreement does not adequately address existing inequalities, it cannot be deemed substantively fair and amounts to unfair discrimination against developing country Member states.

Chapter 10

Concluding remarks

10.1 Deductions

The provisions of the WTO Agreements analysed in this thesis comply with the requirements for formal or procedural equality. This is a conclusion which can be drawn from the fact that all states are bound by the same provisions, except where exemptions are granted to the LDCs. Where special and differential treatment is extended to developing economies, this preferential treatment is mostly limited to the implementation of the various provisions and not to the actual provisions themselves. Once the extra time extended to the developing economies for implementation has lapsed, they are expected to adopt and implement the same provisions as the developed states, regardless of whether these provisions are of particular relevance to the development needs of the individual countries.

The extra time given to developing states is an example of special and differential treatment that is WTO enforceable. This is not the case with the provisions providing for technical, financial and information assistance to be extended to the developing states. The language of these provisions is suggestive, as opposed to obligatory. Most of the provisions relating to special and differential treatment are linked to bilateral negotiations between developing and the developed states. The manner in which the preferential treatment is presented within the WTO in fact misrepresents the actual preferential treatment to be received by the developing economies, as aid is not forthcoming through normal WTO channels but is, instead, dependent upon bilateral negotiations between states. Stevens supports this conclusion. He states that there is no action that an aggrieved developing country can take to compel another Member or international organisation to take actions that it believes are consistent with undertakings by the industrialised states.[1] As with the extended implementation period, the aid provisions do not infringe upon the actual provisions of the various Agreements, except for specific exemptions given to the LDCs.

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1 Stevens (2002:4). Such actions might include improvement of access to distribution channels and liberalisation of market access in sectors of export interest to developing economies and LDCs.

Developed and developing countries, and in some cases, the LDCs, are therefore bound by the same provisions. The special and differential treatment, which appears to be a deviation from normal procedural fairness, cannot actually be defined as being substantively fair as it is neither outcomes-based nor does it provide for differently situated groups to be treated differently.

Apart from questions regarding the efficiency and effectiveness of the actual WTO provisions in promoting the growth and development needs of the developing countries, there is also the question of the efficiency of the special and differential treatment. There is no consistency in the length of time given to the developing countries before they have to adopt the provisions of the various Agreements as extensions vary from Agreement to Agreement. There are also no guarantees that these extensions are economically viable or based upon sound economic reasoning. It is doubtful that developing and LDCs will be able to achieve the conditions necessary for the successful implementation of the relevant Agreements within the periods laid out. Stevens who states that the periods given for implementation imply that some organisation has assessed the implementation capacity of the developing economies and concluded that this is a realistic time period. No such assessment was actually made, with the agreed figures being purely negotiated ones. The dates are those that all parties were actively or passively willing to accept. Stevens argues that while the special and differential treatment provisions allow the LDCs to seek further extensions upon request, no objective provision has been put forward on which to assess whether or not such a request is justifiable.[2]

The non-enforceability of the preferential assistance provisions of the various Agreements has serious implications for the ability of the developing economies to implement their obligations under the WTO Agreements successfully. Because aid and other technical assistance is not readily forthcoming, the developing economies cannot rely on bilateral negotiations to furnish any satisfactory outcomes, especially since the provision of aid and assistance is voluntary. Fukasaku[3] states that implementation of the WTO provisions by the developing economies is hindered by the lack of operational funds necessary to carry forward the reforms. Because preferential treatment provisions on technical

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2 Stevens, op cit note 1 at 5.

3 Fukasaku (2000:19).

assistance are not binding commitments under the WTO Agreements, sufficient amounts of additional funds are not forthcoming voluntarily. A study of the implementation of WTO Agreements suggests that effective implementation and compliance require a fair amount of investment in capacity-building and technical assistance. The successful implementation of WTO rules is also very costly. While the actual costs of implementing WTO Agreements may differ across countries, the costs incurred by the LDCs are still very high and may, in some cases, be a full year's development budget.[4]

The special and differential treatment given to developing economies has, upon application, proved to be less beneficial to the interests of the developing countries than it may have appeared upon paper. The increased implementation periods have, without the required assistance, not been as useful to developing country interests as they could have been if technical, financial, technological and other aid had been mandatory. Special and differential treatment is also more beneficial to the LDCs than the normal developing economies who are expected to adopt the same measures as the industrial countries on almost the same terms.

Not all preferential treatment has been as inefficient as the official special and differential provisions of the WTO, however. The market access preferences which the OECD countries have agreed to extend to almost all commodities exported by LDCs will be very beneficial to these countries as increased trade with the industrialised economies may provide the impetus needed to expand and differentiate their trading sectors. The increased market access provisions by the industrialised countries are amongst the few positive forms of preferential treatment received by the LDCs. Once again, the developing countries which are not least-developed are at the mercy of global markets because their need for differential treatment is not being recognised.

Regardless of the movement towards greater liberalisation of developing economies and the doubts about the effectiveness of import substitution in promoting growth, the success of unregulated liberalisation of domestic markets in promoting growth and development is, as yet, not fully tested. While countries like Singapore, Hong Kong and Taiwan are often quoted as successful examples of the effectiveness of open markets in promoting growth, the fact that these markets are highly regulated

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4 Fukasaku, op cit note 3 at 19.

and subject to stringent government controls is often overlooked and underplayed.[5] Without many natural resources upon which to rely, these economies have not had many options open to them, apart from greater liberalisation of markets. While the WTO focuses on increased liberalisation of domestic industries, there is a gradual move away from direct state intervention which is being increasingly enforced by the WTO Agreements. As example of such behaviour is the evident in the Agreement on Subsidies and Countervailing Measures. Although the reduction of subsidies and countervailing measures makes sound economic sense and is conducive to greater liberalisation, there appears to be two approaches to the elimination of subsidies. While those countries which did not apply for agricultural subsidies prior to the Uruguay Round are prohibited from using export subsidies in their agricultural sectors, those which are currently applying agricultural subsidies are permitted to maintain most subsidies, so long as they are not directly trade distorting. The reduction of direct state intervention has effectively removed many options which would have been opened to the developing economies. Moreover, while the WTO Agreements reflect neoclassical values, there does not appear to have been much research done on the actual needs of developing countries or the policies which would contribute towards the increased growth of economies at the initial growth stages.

Analysis of the actual WTO Agreements suggests that they promote and further the needs of the developed countries. This is evident from the types of Agreements included in the Uruguay Round negotiations, such as the Agreements on TRIPS, TRIMs, GATS and Rules of Origin. While these Agreements have some positive implications for the developing economies, they are reflective of the needs of the industrialised states and the problems experienced by them. Even Agreements which appear to favour developing states, for example, the Agreement on Agriculture, favour the interests of the industrialised states. There is therefore a clear imbalance between the power wielded by the different categories of negotiating states. While the developing economies make up the majority of WTO Member states, their interests are very poorly represented. This lack of representation can be traced to the negotiating process. There is at present an imbalance of power in the creation of the rules. This imbalance leads to rules which reflect the unequal bargaining position of states. Where states

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5 Soon and Stoever (1996:317-340). This article contains an analysis of the Singapore government's growth and development strategy. The analysis suggests that without strong government and adequate government controls, the Singapore growth miracle would not have been as profound.

are not evenly matched or without equal economic power, the test for fairness requires that the system be structured in a way which favours those with less power, therefore allowing for the interests of those without much negotiating power to be given equal, if not greater weight, than those with greater negotiating power. Where the power imbalance does not favour the underdog, the outcomes of the negotiating process may be unfair as they will allow an unfairly discriminatory regime to be applied. The application of rules and the underlying power play must be restricted to natural assertion of sovereign power and must not be an abuse or overreach of one country's sovereign power over another. The process of creating rules should not entrench existing inequalities or advantages, thus allowing for dominance of the negotiating process by privileged groups. While the adoption of the results of any negotiating round require consensus by all states, the actual negotiations are concession-based. The economic power and reach of a state determines the outcome of any negotiating issue.

The industrialised countries, with their greater access to capital, technology and consumer power as well as the size of their markets, have more economic power than the developing economies. Global markets are also dominated by companies from OECD states. The power of the developing economies is dependent upon them acting together. This power is, however, eroded by the fact that there exist, within the developing economies, various subgroups which do not necessarily share the same interests or seek the same outcomes. Negotiations, while seen as being multilateral, are actually carried out in small groups by influential states or bilaterally. While the present negotiating process favours developed country interests, it undermines the negotiating strength of the developing states by forcing them to negotiate in the same manner as the developed states. Furthermore, the negotiating process entrenches economic power, and makes access to the fruits of development negotiating currency. While the developing states may be lacking in economic power, they are not powerless. Nonetheless, by separating the developing economies and failing to recognise that the developing economies require different rules, the developed economies have taken from the developing economies an important negotiating tool. The bias in the negotiating process has permitted the developed economies to dominate the negotiating process and ensure that their global monopoly remains unshaken.

Even where rules are ostensibly fair in that they make provision for substantive issues such as redress, situations do arise where an abuse of power results in an unfair application of these rules. An example

of such abuse of power can be found in the application of the special and differential treatment provisions. While these provisions appear to provide the developing states with access to technical, financial, technological and informational assistance by the developed states, they are in practice insubstantial as they link these non-obligatory provisions to bilateral negotiations. Because these provisions are non-enforceable and voluntary, access to any form of aid may require further concessions to be made by the developing economies. The nature of these provisions is such that even where the developed states appear to be acting in the interests of development, they retain their negotiating strength and stranglehold on the negotiating process. Redress does not really occur as the developing countries have to make concessions which they can ill afford in order to receive minimal and often inadequate support. Examples can also be found in the Agreements on Agriculture and Textiles and Clothing. While non-tariff barriers on agricultural products and textiles and clothing have been converted to tariffs, the tariffs on these products are extremely high. The reduction of these tariffs is likely to take time and provides the developed states with a means of controlling the negotiating goals of the developing economies.

There is also the issue of agricultural subsidies and the removal thereof. While the reduction and elimination of agricultural subsidies is important for food-exporting developing economies in that it will enable them to obtain higher prices for their agricultural products on global markets, safeguard their domestic markets from agricultural dumping by the developed nations and increase their quota of global agricultural trade, net food-importing countries have sided with the developed economies in seeking to prevent the elimination of agricultural subsidies. Through "Green and Blue box" subsidies the developed economies have been able to maintain and even increase the level of subsidies given to their domestic producers. An Agreement which is meant to increase the access of developing country agricultural products to developed country markets has instead been used to maintain the protection of these very markets and increase the yield of developed country agricultural products.

In a situation where inequalities exist between groups which prevent the disadvantaged from advancing their interests or obtaining a fair opportunity to succeed, a substantive approach to equality must be adopted. For redress to be truly achieved, the interests of the disadvantaged groups must be placed before the interests of those who are advantaged. Power is therefore not to be balanced but

should rather be structured to favour the interests of the disadvantaged. Where power is so structured, the ability of the more advantaged groups to abuse their power will be neutralised. In the WTO, the interests of the developed economies are placed before those of the developing economies, who have to abide by provisions which do not necessarily reflect their economic realities. The fact that this has occurred indicates that there is an imbalance of power which favours the industrialised countries. This is an outcome which cannot be allowed to continue if the developing economies are ever to achieve levels of growth necessary to upgrade the living standards of their citizens.

10.2 Challenges for Doha

The current Doha Round has been labelled a "development round". It gets this title from the Doha Declaration, which provides that an attempt will be made to address development issues in the new round.[6] The multilateral negotiations seek to cover seven topics. Six of these topics: implementation, agriculture, services, industrial tariffs and WTO rules: subsidies, antidumping and regional trade agreements, are to be completed as a single undertaking by 2005. Dispute settlement, the seventh topic, is to be completed by May 31, 2003. Despite the apparent focus on development, the developing economies view the Doha Declaration as being biased in favour of developed country interests because it does not correct the imbalances resulting from the Uruguay Round. Disagreement also stems from the lack of progress made in placing increased market access for textile products on the Agenda. The Declaration states that any new concessions by developed countries will have to be matched by new concessions by developing countries. The mention of special and differential treatment does not in itself make binding, any best endeavour provisions not previously honoured by developed countries. Issues of importance to developing countries such as trade and debt, finance and technology transfer, small economies and special and differential treatment fall under the non-negotiating work programme.[7]

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6 Mbekeani (2002:1).

7 Mbekeani, op cit note 6 at 1-2.

The ACP countries have made short-term gains however. Two waivers were adopted which grant the ACP non-reciprocal preferential access to the EU markets until 2008 and permit the EU to maintain a separate quota for ACP banana exports from 1 January 2002 to the end of 2005. The Declaration also gives developing countries some reprieve in the areas of medicines through increased flexibility in the use of compulsory licensing.[8] Despite these gains, the Doha Agenda still appears to favour the developed economies who have a greater say in the negotiating Agenda. This does not bode well for the interests of developing economies in the new round.

According to Whalley[9] the main negotiating thrust of the developing economies has so far been more negative than positive, such as, to keep environment and labour standards off the agenda, instead of looking for opportunities for enhanced trade through negotiated barrier reductions. The problem with the present system is that the developing economies are negotiating from a position of disadvantage which can only be changed through restructuring the negotiating structure utilised by Member states. The developing countries would be better off if they challenged the current negotiating system and sought to put into place a system which prevents abuse of power by both sides. This would be a system which permits normal negotiating behaviour and prevents coercion or threats by states. A good place for states to begin would be to recognise that a differential approach to trade is necessary as one set of trading provisions cannot be expected to solve the problems experienced by all groups of states effectively. Where concessions are made, there should be independent studies done on the impact of negotiated provisions on the economies of all parties. If an economic impact study of all proposed rules is made mandatory, there will be less room for abuse of negotiating power.[10]

Where more attention is paid to the economic effects of potential Agreements, it will be easier for the developing economies to justify seeking increased access to developed markets and lobbying against the high levels of protection of sensitive industries in these markets. There is, at present, no real distinction made between sensitive mature industries in developed economies and vulnerable fledgling

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8 Mbekeani, op cit note 6 at 2.

9 Whalley (1999:17).

10 See Stevens, op cit note 1 at 21-27 for his discussion of how subgroups of countries for the purposes of special and differential treatment may be determined within the WTO.

industries in developing economies. This is a distinction which should be made as it provides grounds for differential treatment in favour of developing economies.

If abuse of power is to be really removed, the right to redress, or legal efficiency, should be adopted and become a binding WTO principle, which works together with the principle which requires special and differential treatment for developing economies. Just as not all Member states are equally developed, the developing economies are at different stages of development and require different levels of preferential treatment. The WTO is mostly interested in the needs of the LDCs, to the detriment of the other developing economies. For the negotiating system to be fair, there has to be recognition of the economic status of all Members, with the level of redress being linked to the growth levels of groups of states. While graduation schemes would be necessary, they should not be determined in an *ad hoc* manner, as occurs at present, but in a more equitable and efficient manner. Preferential treatment should, in addition, go beyond implementation and actually address the needs of the preferred groups. A formal approach to development should be avoided in these circumstances as it maintains the *status quo* and limits the impact of special and differential treatment to procedural instead of substantive fairness. As a result, the process becomes more important than the impact. Where special and differential treatment for developing states is negotiated, the results should be made binding on the developed states, especially where these provisions relate to increased market access, preferential access to developed and advanced developing country markets, technical, technological, financial and informational assistance and undertakings to respect the national heritage and indigenous knowledge of developing country citizens. Fukasaku's analysis agrees with this conclusion, and provides that special and differential treatment should be sought in areas relating to market access, trade capacity building and technical assistance.[11]

Because bilateral negotiations tend to be exclusionary, developing countries would benefit from a negotiating system which permits those states with the least economic power, and hence the least say, access to negotiations which affect them. Because these states are often ignored or have other states acting on their behalf, there has been a tendency within WTO negotiations to exclude the LDCs from WTO Agreements. While such exclusion permits the LDCs to act outside of WTO provisions, it also

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[11] Fukasaku, op cit note 3 at 11-19.

prevents them from reaping the full benefits of the WTO process and permits the more industrialised states to avoid the responsibility of providing them with the proper aid or preferential treatment which they need. The LDCs should, therefore, not only be given preferential treatment by developed and developing countries but should also be given access to the relevant negotiations as well. There is a tendency within the current system for preferential treatment to be provided only if it does not threaten the dominance of more established states or interfere with their global strategies.[12] Where redress is to be administered correctly, some disruption of prevailing trade patterns is both reasonable and necessary as changes in market dominance are indicative of changing power. For the developing countries to achieve greater growth and development, they have to achieve greater economic power. This means that established trading patterns will have to be disrupted. Differential treatment will therefore have to be treatment which upsets and challenges the *status quo.*

Regardless of the issues which the developing countries seek to address through the Doha Round, it is important that they ensure that gains from negotiations are real. Emphasis should also be placed upon economic efficiency and determining the impact of proposed provisions on the growth prospects of their individual economies. Without a modification of the present negotiating process, however, it is unlikely that the developing countries will be able to negotiate many meaningful changes.

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12 See Stevens, op cit note 1 at 16.

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