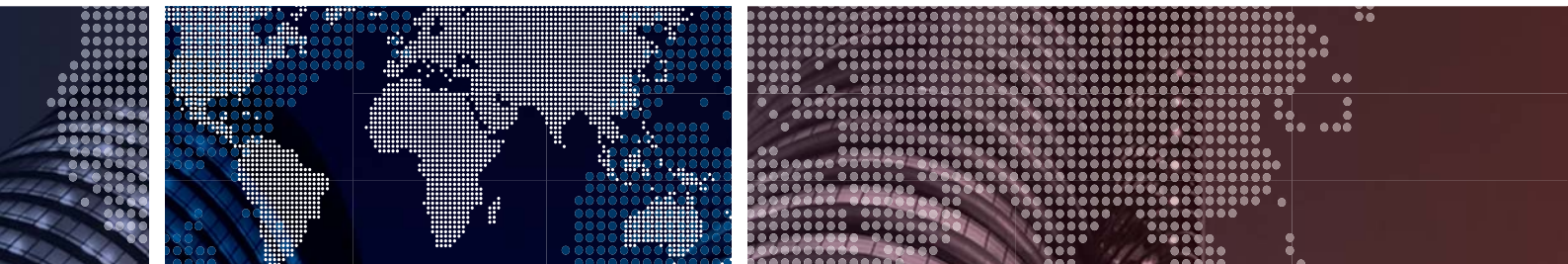




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FROM DRIFT TO DEALS: ADVANCING THE WTO AGENDA



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TRADE AGENDA

JUNE 2015

Gary Hufbauer, Euijin Jung, Sean Miner,
Tyler Moran and Jeffrey Schott

REPORT TO
ICC WORLD TRADE
AGENDA
JUNE 2015

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DEALS: ADVANCING
THE WTO AGENDA**



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Assisted by Euijin Jung, Sean Miner, Tyler Moran

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EXECUTIVE SUMMARY

After seven years of stagnation, the World Trade Organization (WTO) received a burst of inspiration at the 9th Ministerial Conference held in Bali in December 2013, with the completion of the Trade Facilitation Agreement and several other accords. It now remains to be discovered whether WTO members will apply the momentum gained in Bali to a broader agenda, launched at the 10th Ministerial Conference (MC10) to be held in Nairobi in December 2015.

To restore itself as a central negotiating forum, the WTO needs a Grand Bargain. The advanced countries should concede the priority demands of developing countries with respect to the Doha Development Agenda – on agriculture and non-agriculture market access (NAMA). In return, developing countries should agree that subsets of WTO members can enter into plurilateral agreements within the WTO framework, provided the agreements are binding only on the signatories. The Grand Bargain would enable the WTO to pursue 21st Century pacts that keep policymakers, business leaders, and the broader public engaged, while answering the legitimate demands of developing members to reduce longstanding distortions to farm trade and manufactures.

This report outlines a work program to carry out the Grand Bargain. While most of the program deals with newer issues, the starting point is agreement on the “traditional” issues of greatest interest to developing countries.

On agriculture, advanced countries should make serious concessions. They should take a lead in eliminating agricultural export subsidies; give duty-free, quota-free (DFQF) market access to Least Developed Countries (LDCs); and reduce their amber box subsidies to the highest annual level paid out since the launch of the Doha Round. The United States should liberalize its agricultural tariff-rate quotas so that they can be filled by willing suppliers.

On NAMA, the advanced countries should accept the tariff formulas proposed in July 2008, even though those formulas require very limited cuts by key emerging countries, such as Brazil, China, India, and South Africa.

In return for these significant concessions, developing countries should agree that new plurilateral agreements can be added to the WTO framework without the unanimous consent of all 161 WTO members, and even without three-quarters majority approval. This constitutional change would acknowledge that the WTO’s greatest potential lies in liberalizing entirely new realms of global commerce, even though not all WTO members are prepared to liberalize at the same pace.

This report outlines nine trade realms that await liberalization and it offers recommendations for frontier agreements on several topics. At or before the Nairobi Ministerial in December 2015, WTO members should adopt the Trade Facilitation Agreement as a protocol to the WTO. This will require the affirmative vote of at least 107 (two-thirds) of the 161 WTO member countries, but to show new resolve, members should unanimously adopt the TFA. Prior to the Nairobi Ministerial, China, Taiwan and Korea should settle their disagreements (centered on flat panel displays) as to the content of the upgraded Information Technology Agreement (ITA). This will give a second “deliverable” to Nairobi, namely the ITA2.

At Nairobi, ministers should call for the conclusion of two plurilateral agreements by the end of 2016. This commitment will show that the WTO is back in business as a negotiating forum.



The Environmental Goods Agreement (EGA), designed to foster free trade in environmentally-friendly products, can be completed with a moderately ambitious list of tariff lines within a year. Then, in 2017 and beyond, new members can join the EGA, the zero tariff list can be expanded, and an EGA-Plus accord might limit the adverse effect of trade remedies – anti-dumping (AD) and countervailing duties (CVD) – as well as local content requirements (LCRs) on trade in environmental goods.

As well in 2016, the Trade in Services Agreement (TiSA) should be concluded – the most ambitious plurilateral agreement now being negotiated in Geneva. At Nairobi, WTO Director-General Roberto Azevedo and the assembled ministers should seek a path for incorporating TiSA within the WTO framework. Among other goals, TiSA should guarantee the free flow of digital commerce and ensure that prudential financial regulations do not become tools of protection.

During the course of 2017, and prior to the 11th WTO Ministerial, the members should launch negotiations on several additional plurilateral agreements. This report offers a menu of possibilities, covering several 21st Century topics. Among the possible agreements, the WTO might initiate an Investment Framework Agreement (IFA) that would resolve contentious weaknesses surrounding investor-state dispute settlement (ISDS) that are common in free trade agreements. Moreover, under WTO auspices, an IFA could link more countries into global value chains. Based on our estimates, the total economic gains from the IFA and other new plurilateral agreements would be substantial, and the pacts would restore the WTO as the foremost global forum for addressing new issues.

The potential pacts outlined in this report would not be easy to negotiate, but countries would greatly benefit from their inclusion within the WTO framework. The Bali Ministerial showed that the WTO can still serve as a forum for multilateral cooperation. The Nairobi Ministerial, in December 2015, will determine whether Bali was the WTO's swan song of drift and decay, or the first step to re-establish the WTO as deal-maker.



CRITICAL MOMENT FOR WTO TALKS

The 9th Ministerial Conference of the World Trade Organization (WTO), held in Bali in December 2013, was a qualified success. The meeting produced the first multilateral accord since the WTO was established in 1995, the landmark Trade Facilitation Agreement (TFA), plus nine other accords regarding agriculture issues of particular concern to developing countries and special preferences for the least developed countries (LDCs). These agreements are listed in Box 1. Together, the TFA and the other nine accords constituted the Bali package.

Box 1. Bali Accords

Trade Facilitation Agreement

- A provision to expedite the movement, release and clearance of goods and to streamline customs procedures.
- A provision to provide special and differential treatments for developing and least-developed countries (LDCs) to determine the implementation commitment and timelines.
- A provision to establish a Committee on Trade Facilitation at the WTO.

Other Nine Accords

- A Ministerial Decision exempting specified general services from the tally of permitted agricultural subsidies.
- An interim agreement on public stockholding for food security purposes linked to a “peace clause” on WTO litigation.
- An understanding on the administration of tariff rate quotas on agricultural products.
- A declaration on phasing out agricultural export subsidies broadly defined.
- A Ministerial Decision pointing to the phase-out of cotton subsidies.
- A decision urging preferential rules of origin for LDCs.
- A decision concerning preferential treatment for LDC service suppliers.
- A decision regarding duty-free and quota-free market access for LDCs.
- A decision to monitor special and differential treatment for LDCs.

The Bali Ministerial rebutted pundits who had long written off the WTO as a viable negotiating forum; in fact, the meeting committed trade officials to formulate a post-Bali WTO work program that would be presented to ministers in December 2014 and recharge the long dormant Doha Round. But the Bali consensus devolved quickly into discord over the sequencing of the procedures to formally adopt the TFA and the resolution of the development issues, putting the entire process of WTO renewal on hold.



Instead of being on the road to recovery with a renewed agenda for multilateral negotiations, WTO members are still undecided, as of spring 2015, about what can be salvaged from the first decade of Doha Round talks and whether the agenda should be supplemented with new negotiating initiatives. As we have argued in our previous reports, the Doha talks drifted because the emerging package of agreements was not ambitious enough nor balanced enough between the interests of developed and developing countries to ensure broad political support and ratification by member governments. Doha progress on agriculture and industrial products should not be lost, but is insufficient to produce the requisite balance to close a WTO deal and must be complemented with new commitments on services and other issues. History teaches that the major trading powers will not change their existing practices and introduce new trade reforms unless there are additional benefits from access to other markets.

Replicating the success of the Bali meeting at the 10th Ministerial Conference (MC10) in Nairobi in December 2015 will be a tough task, but critical to the world trading system. Despite calls to put the finishing touches on a Doha package after almost 14 years of fitful negotiations, WTO diplomats sadly are still undecided on the basic building blocks of a possible deal. To be sure, the prospective WTO package needs to draw extensively on the progress achieved during Doha's first decade. But the world economy has changed dramatically since the near conclusion of the Doha Round in 2008, and negotiators will have to recalibrate the deal to reflect altered market realities.

To that end, we offer analysis and recommendations of key issues that WTO members need to include in their work leading up to MC10 in Nairobi as well as initiatives that need to be advanced from the starting point of plurilateral talks to the end result of multilateral application. In some areas, our proposals would strengthen existing WTO provisions; some may supplement the original Doha agenda; and some may proceed at first via plurilateral negotiations among a subset of WTO members. But before we can proceed with the new analysis, it is important to explain what has happened since Bali. The road to WTO recovery is still full of potholes that could give trade talks another flat tire.

The Bali Agreement on TFA¹

As the WTO's first broad multilateral accord, members had to formulate procedures for adding TFA obligations to the existing WTO rulebook. The ministers established a preparatory committee to "draw up a Protocol of Amendment (the "Protocol") to insert the Agreement into Annex 1A of the WTO Agreement." Under this procedure, the Protocol had to be approved by a consensus of WTO members, meaning that any objections could prevent it from being implemented. At Bali it was assumed that the Protocol would be approved by the WTO General Council "no later than 31 July 2014" because all the trade ministers in attendance accepted the package of Bali decisions.²

TFA is a complex document, with tiers of obligations – more severe for developed countries, considerably less severe for developing countries. But the commitments all have a single purpose: to slash red tape and corruption at sea ports and cargo airports and thereby dramatically reduce the time and expense for merchandise to enter and leave a country.

1 This description is drawn directly from Jeffrey J. Schott and Gary Clyde Hufbauer, "Putting the Trade Facilitation Agreement Back on Track after India's Obstruction", Peterson Institute for International Economics, RealTime post, 5 August 2014.

2 TFA could have been adopted as a Ministerial Declaration, but this route was not chosen out of concern that the WTO Appellate Body would not accord a Declaration the same legal standing as Protocol of Amendment. In light of India's subsequent actions, that was a mistake.



TFA does not require developing country members to fully implement the agreement upon entry into force. Instead they were encouraged to notify, by 31 July 2014, those commitments that they would implement at the start, those that would be implemented after a transitional period, and those that would be undertaken only after “the acquisition of implementation capacity” (categories A, B, and C, respectively). These commitments were supposed to be annexed to the TFA and the Protocol adopted by the General Council in July 2014. The task ahead is to achieve these goals at the Nairobi Ministerial meeting in December 2015.

In June 2014, as the deadline approached to incorporate the TFA within the WTO legal framework, India objected. India insisted that the food security agreement must be finalized before TFA could become a binding part of the WTO.

Through its “peace clause” the Bali deal had ensured that no litigation, at least through 2017, could be initiated against India and other developing members if, through public stockpiling outlays, they exceeded the subsidy limits set forth in the Agreement on Agriculture (AoA). The relevant decision text reads:

PUBLIC STOCKHOLDING FOR FOOD SECURITY PURPOSES
MINISTERIAL DECISION OF 7 DECEMBER 2013

[introductory language omitted]

1. Members agree to put in place an interim mechanism as set out below, and to negotiate on an agreement for a permanent solution¹, for the issue of public stockholding for food security purposes for adoption by the 11th Ministerial Conference [to be held in 2017].
2. In the interim, until a permanent solution is found, and provided that the conditions set out below are met, Members shall refrain from challenging through the WTO Dispute Settlement Mechanism, compliance of a developing Member with its obligations under Articles 6.3 and 7.2 (b) of the Agreement on Agriculture (AoA) in relation to support provided for traditional staple food crops² in pursuance of public stockholding programmes for food security purposes existing as of the date of this Decision, that are consistent with the criteria of paragraph 3, footnote 5, and footnote 5&6 of Annex 2 to the AoA when the developing Member complies with the terms of this Decision.³

[notification conditions omitted]

1. The permanent solution will be applicable to all developing Members.
2. This term refers to primary agricultural products that are predominant staples in the traditional diet of a developing Member.
3. This Decision does not preclude developing Members from introducing programmes of public stockholding for food security purposes in accordance with the relevant provisions of the Agreement on Agriculture.

India’s core complaint was that the public stockholding component of the Bali package required further (and often contentious) negotiations to reach an agreed text. By contrast, TFA was a done deal, which set it apart from other elements of the Bali package. India saw the privileged status for TFA as unfair and unbalanced.



In response to India's action, the United States and the European Union offered a "clarification" of the Bali decision.³ In early November 2014, a compromise was reached: food stockholding programs in developing countries would not be subject to WTO dispute procedures until a permanent agreement is reached on the appropriate scope and conditions of maintaining such programs.⁴ As a consequence, the path is now clear for WTO members to negotiate the central post-Bali traditional issues plus several new issues.⁵ Prospective negotiations occupy the remainder of our report.

However, it is worth pausing to observe that the compromise on food security was a deal worth doing because delayed implementation of TFA would have carried a high cost. Over the course of a decade, full implementation by all WTO members could slash sea port and air cargo red tape, substantially reduce corruption, and deliver the US\$1 trillion benefits and the 21 million jobs per our estimates in Hufbauer and Schott (2013). Zaki (2013) calculated a similar magnitude. Subsequent to our estimates, the World Economic Forum, Bain & Company, and the World Bank published a detailed logistical analysis in 2013 that arrived at even larger benefits, but contingent on dramatic infrastructure upgrading that was not contemplated in TFA. In whatever manner calculated, most TFA benefits will accrue to developing countries, but the size of benefits depends on the speed and extent of TFA implementation. The Office of the US Trade Representative (USTR), among others, is seeking to assure that TFA enters into force before the WTO's Nairobi Ministerial in December 2015. It has now been ratified by four WTO members (Hong Kong, Mauritius, Singapore, and the United States), and ratification by the European Union (28 members) is assured. However, 107 members must ratify TFA before it can be joined as a Protocol to the legal text of the WTO, so work needs to be done to ensure its implementation at or before the Nairobi Ministerial meeting.

3 *Washington Trade Daily*, 24 September 2014, Vol. 23, No. 190.

4 *Washington Trade Daily*, 6 November 2014, Vol. 23, No 221.

5 For a perceptive analysis of the path ahead, see Richard Eglin, "An Honorable Draw or Continuing Gridlock in Doha Round," presentation at the Cordell Hull Institute, Washington DC, 29 September 2014.



GOALS FOR NAIROBI 2015

Time has passed since the Doha Development Agenda (DDA) negotiations ran aground almost seven years ago, in July 2008. Much has been written to explain the breakdown, and there is no need to rehearse the story once again.⁶ Three major events have altered the policy agenda in the intervening period.

First, and partly as a consequence of the WTO's failure, three mega-regional negotiations now occupy center stage in world trade policy: the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Atlantic Trade and Investment Partnership (TTIP).

Second, the remnants of the July 2008 "breakdown ministerial" have been distilled somewhat to fashion a more manageable agenda moving forward. In this respect, a good deal of progress was made in the run-up to the Bali Ministerial, held in December 2013.

Third, appreciation has grown of the role played by a small number of multinational corporations (MNCs) and the related importance of global value chains (GVCs) as conduits for world commerce. Extrapolating from US experience, possibly just 8000 MNCs account for 75% of world trade. This fact highlights the importance of slashing trade frictions on intermediate goods and services – the trade facilitation agenda writ large – a fact that has led some countries to pursue unilateral liberalization in order to secure a place in the world's GVCs.

In light of these events, we survey the main topics on the Doha Round agenda and suggest compromise solutions that could be achieved by the Nairobi Ministerial in December 2015. In our view, a grand bargain is in sight. The United States, the European Union, and other developed countries should make the largest possible concessions on traditional issues – namely agriculture, duty-free quota-free (DFQF) treatment for LDCs, and non-agricultural market access (NAMA) – in exchange for acceptance by all WTO members that dramatically different negotiating approaches will be accepted for new issues, as outlined below in the post-Nairobi section of this report. In addition, prior to Nairobi, members should conclude the expansion of Information Technology Agreement (ITA2), make good progress on the Environmental Goods Agreement (EGA), and open the Trade in Services Agreement (TiSA) to China, India, Brazil and other emerging countries that are willing to contribute.

Agriculture

Until the 8th WTO Ministerial, held in Geneva in December 2011, agricultural talks were moving very slowly based on the "draft modalities" text, a 123-page document compiled in 2008 by the chairman of the Committee on Agriculture, Crawford Falconer of New Zealand. The text reflected eight years of negotiations.

At the 8th Ministerial meeting five "early harvest" items in the agricultural agenda were identified for priority action. These five items were addressed at the 9th Ministerial meeting held in Bali in December 2013. They are:⁷

⁶ See Blustein (2009); Schott (2011); and Matoo and Martin (2011).

⁷ The description of the Hong Kong and Bali Ministerial agreements is paraphrased from http://wto.org/english/thewto_e/minist_e/mc9_e/desci40_e.htm



1. Elimination of export subsidies
2. Administrative reform of “tariff rate quotas” that are persistently under-filled
3. Permission for developing countries to stockpile food for food security purposes
4. Expanding the list of “green box” general services of interest to developing countries
5. Limiting subsidies to cotton production by the United States and other countries

In addition to these five items, the vexing question of domestic agricultural subsidies remains high on the list of unfinished business. We will discuss that topic after surveying the five Bali items. We will also summarize the agricultural tariff bargains struck in 2008. We see no reason to revise those bargains, apart from possible fresh concessions on bound rates by India as part of a deal on stockpiling for food security.

Export subsidies. At the 6th Ministerial, held in Hong Kong in 2005, WTO members committed to eliminate, by 2013, all subsidies to agricultural exports, including financial contributions and other advantages gained from government-supported export credit and insurance, food aid and state trading enterprises. This end date was contingent “upon the completion of the modalities.” Developing countries would have an extra five years to fulfill this obligation.⁸ The United States and European Union did not have fundamental problems with prohibiting farm export subsidies but could only commit to doing so as part of the final Doha package.

At the Bali Ministerial, the commitment was watered down. Members promised to “exercise utmost restraint” in using any form of export subsidy and also promised to “ensure to the maximum extent possible” progress in eliminating all forms of export subsidies. Again, however, these promises are conditioned on a single undertaking that covers all elements of the DDA package.

The Bali commitment was unsatisfactory to most countries. Developing WTO members insist that developed WTO members should accept hard limits (and even elimination) of their agricultural export subsidies, but they argue that developing countries should retain the flexibility to promote their agricultural exports with subsidies. Table 1 lists the top 20 agricultural exporters, several of them developing countries such as Brazil, China and India. It is simply not plausible to ask all the developed countries to accept hard limits if major agricultural exporters in the developing world are unconstrained.

RECOMMENDATION

Developed members should agree to eliminate agricultural export subsidies when the WTO agreement enters into force. Developing countries that rank among the top 20 agricultural exporters (table 1) should accept hard limits on their export subsidies, but other developing countries, as well as LDCs, should only be obligated by the soft limits expressed in the Bali declaration.

⁸ See para.6 of Hong Kong Declaration, 18 December 2005, WT/MIN(05)/W/3/Rev.2



Table 1 | Top 20 Agricultural Exporters, 2013 (billions)

European Union	156,3
United States	147,1
Netherlands	101,9
Germany	87,6
Brazil	86,4
France	77,8
Belgium	48,6
China	47,5
Spain	45,7
Canada	45,3
Italy	42,6
India	42,3
Argentina	40,6
Australia	37,1
Indonesia	29,4
Malaysia	25,5
Thailand	24,7
Poland	24,7
Mexico	23,4
New Zealand	23,2

Source: wits.worldbank.org

Tariff rate quotas. Tariff rate quota systems (TRQs) permit a certain quantity of imports to be admitted tariff-free, or at low tariff rates, while imports in excess of the quota limit pay a high tariff. These systems are commonly used for sensitive agricultural imports. The quotas are, in turn, divided up and assigned to exporting nations, generally in rough proportion to their historical exports to the importing country. The trade issue arises when the overall quota is persistently under-filled.

The proposal floated at the Bali Ministerial would require countries with under-filled TRQs either to accept quantities on a first-come, first-served basis, or to issue “automatic licenses on demand” up to the quota limit. However, developing members were exempted and the new provisions would lapse after six years for all members unless renewed. Finally, any developed members could choose to opt-out of the new provisions. The United States, unlike all other developed members, did choose to opt-out.

RECOMMENDATION

The United States should opt-in to the new provisions. This will be an enticing carrot for some WTO members that are otherwise hesitant to accept the slimmed-down package of traditional issues.



Stockpiling for food security. This is by far the most contentious issue on the agricultural agenda. Money spent for food stockpiles is counted as an “amber box” subsidy and, for developing countries, is subject to two limits under the Marrakesh Agreement: for non-specific support the limit is 10% of the total value of agricultural production; for commodity specific support, the limit is 10% of the value of production of that specific commodity. India argues that the 10% limits are too low when, as in its program, the stockpiled food is delivered free or at nominal prices to poor families. However, according to India’s recent notification, its total agricultural subsidies in 2013 amounted to only 4% of the value of production (table 2).

Table 2 | Actual Agriculture Producer Support Estimates, 2012

	\$ Billions	% of Production value
Japan	52,0	61%
European Union	112,2	23%
Indonesia	24,9	21%
China	167,1	18%
Canada	7,6	16%
Mexico	7,1	13%
United States	33,5	9%
Brazil	8,1	5%
India	13,8	4%
Australia	0,9	0%

Source: OECD: Producer and Consumer Support Estimates database. Some data converted to dollars. EU: €1 = \$1.30. Brazil: BRL1 = \$0.46. China: CHY1 = \$0.16. Canada: CAD1 = \$0.97. Australia: AUD1 = 0.95. Indonesia: IDR1 = \$0.000094. Figure for India from the Sept 11, 2014 issue of Washington Trade Daily

India proposed to count stockpile funds as “green box” subsidies, exempt from any limit. The United States and other agricultural exporters objected, fearing that an exemption would totally undermine any discipline on agricultural subsidies. As table 1 shows, India was among the top 20 agricultural exporters in 2013. In fact, India’s agricultural exports have soared, from US\$5 billion in 2003 to over US\$40 billion in 2013.⁹ Cereals (mainly wheat and rice) are a major Indian export, amounting to US\$10 billion in 2013, and at the same time the leading beneficiary of stockpile programs. Farm organizations in the United States and elsewhere adamantly oppose a trade deal that would enable India or other major developing country exporters to further boost their agricultural exports by unlimited “green box” subsidies. Disagreement over the Indian proposal, which had been offered in 2008, was a major cause for the breakdown of the 7th Ministerial held in Geneva in 2009.

At the Bali Ministerial, the compromise agreed was that WTO members would use “due restraint” in lodging WTO complaints against food security stockpile programs (a “peace clause”), at least until the 11th Ministerial in 2017. The declaration language defining the duration of the “peace clause” was ambiguous as to whether it would expire in 2017 or would endure until an agreement on food security was reached. However, in June 2014, the United States and the European Union offered India a “clarification” that would ensure the continuance of the “peace clause” until the latest possible date (2017 or an agreement).

9 USDA Foreign Agricultural Service, “India Sees Surge in Agricultural Exports to Least Developed Countries,” International Agricultural Trade Reports, 23 September 2014, www.fas.usda.gov/data/india-sees-surge-agricultural-exports-least-developed-countries.



Disagreements between India, the United States and the European Union remained on eligible products and safeguard measures to ensure that stockpile programs do not disrupt international trade. Of particular concern to US and EU agricultural producers is the potential for the indirect use of stockpile funds as an export subsidy, when foodstuffs are nearing their “sell-by” date, and the export market looks like an attractive site for disposition.

In July 2014, when the time came to ratify the Bali Ministerial package as an integral part of the WTO accords, India surprised the world. It insisted that, unless the “peace clause” was immediately made permanent, and food security programs were insulated from any WTO challenge, India would refuse to accept the Trade Facilitation Agreement (TFA) as an agreement within the WTO framework. In turn, the Quad (United States, European Union, Japan and Canada) blocked negotiations on all “post-Bali” issues until the TFA question was resolved.

Indian Prime Minister Narendra Modi met US President Barack Obama in Washington in September 2014, and instructed their trade officials to negotiate an acceptable compromise. The bargain was reached in November 2014. WTO members agreed to a revised “peace clause” that committed them not to challenge India and other developing countries for exceeding subsidy limits related to stockpiling programs. The “peace clause” remains in force until a permanent solution is agreed.¹⁰

“Green box” general services. The Bali Ministerial accepted the G-33 proposal that the list of green box general services, listed in Annex 2 of the Agreement on Agriculture (AoA), should be expanded to include land rehabilitation, soil conservation and resource management, drought management and flood control, rural employment programs, issuing land ownership titles and settlement programs. The expansion is subject to the general proviso of Annex 2 that these and other green box measures “shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.”

RECOMMENDATION

The Bali decision should be inscribed as an addendum to Annex 2 of the AoA.

Cotton subsidies. US cotton subsidies have been a flash point in agricultural talks at least since 2005. The Hong Kong Ministerial held that year issued a declaration calling on developed countries to eliminate “all forms” of export subsidies by 2006, and to open their markets to cotton exported by LDCs on a duty-free, quota-free basis. In 2002, Brazil, joined by the “cotton four” (Benin, Burkina Faso, Chad and Mali), brought a WTO case against US cotton subsidy programs, claiming that they acted as export subsidies and distorted world markets to the disadvantage of producers elsewhere.

Brazil prevailed in 2004, and for several years the United States paid monetary compensation to avert retaliatory measures (including against US intellectual property rights) authorized by the WTO. In September 2014, the United States and Brazil reached a memorandum of understanding that the United States would pay a US\$300 million lump-sum compensation, to be distributed to Brazilian cotton farmers, and Brazil would drop its WTO case and not launch new actions on cotton.

Prior to the Bali Ministerial, the “cotton four” renewed the call for LDCs to enjoy duty-free, quota-free market access to developed country markets, and for developed countries to

¹⁰ See, “US-India WTO Breakthrough Includes Council Decision on Peace Clause,” *Inside US Trade*, 14 November 2014, p. 1.



immediately end their export subsidies. The Bali Declaration was much less definite: it simply called for intensive negotiations during 2014 to achieve a substantial reduction in subsidies, and for greater assistance to cotton producers in developing countries.

The key obstacle to an agreement on cotton subsidies is the fact that developing countries are major exporters (table 3). Calls from the Hong Kong Ministerial in 2005, insistently repeated since, and voiced again by the “cotton four” at Bali, limit their target to cotton exports from developed countries. Critically, this limitation excludes China and India, the world’s first and second largest exporters of cotton. It is not realistic to expect the United States to curb its domestic support programs, which indirectly act as export subsidies, when China, India and Pakistan are free to maintain programs with similar trade effects.

Table 3 | Top 10 Exporters of Cotton, 2013 (\$ billion)

China	17,5
India	11,3
United States	7,5
Pakistan	5,3
Australia	2,5
Turkey	1,9
Italy	1,8
Germany	1,3
Brazil	1,2
Indonesia	0,8

Source: wits.worldbank.org

RECOMMENDATION

China, India and Pakistan should join the developed countries (principally the United States, Australia and a few European countries) in eliminating cotton programs that act as export subsidies. Moreover, developed countries (but not developing countries) should give duty-free, quota-free market access to LDC exporters of cotton.

Domestic agricultural subsidies. The Bali Ministerial skirted the issue of domestic agricultural subsidies, but they remain high on the list of unfinished business in the Doha Round. So-called “amber box” subsidies take many forms. Permitted levels of amber box subsidies – both national totals and product subtotals – are calculated by reference to metrics spelled out in the Aggregate Measurement of Support (AMS) in Annex 3 of the AoA. For major agricultural exporters, table 2 summarizes actual subsidies, measured by the extent of producer support expressed as a percentage of domestic production, for the year 2012.

In 2013, the European Union renewed its Common Agricultural Policy (CAP) until 2020. In 2014, the US Congress passed a new farm bill that restructures some key programs and will guide US farm policy until 2018. Since the EU and the US are the two countries most criticized for their agricultural subsidies, it is worth emphasizing that the hands of the respective trade ministers are virtually tied



with respect to legislative changes. However, EU agricultural programs can set maximum limits on authorized subsidies by overall levels, within the AMS limits. For US programs, the \$19.1 billion amber box limit could be exceeded in worst case events although that seems unlikely.¹¹ Actual subsidy payments depend on market and growing conditions, notably prices received by farmers and the extent of loss from adverse weather.

But as discussed in Doha up to 2008, WTO members wanted the United States and European Union to sharply lower their AMS caps. In the US case, consideration was given to a cap under US\$10 billion. At the time, such a cap was well above current disbursements and that situation continued to hold through the 2012 subsidy notification.¹² But with softer commodity prices, that cap would now be much easier to breach. In short, agreements on domestic support commitments are now much harder to achieve than in 2008 because of changes in market conditions and US farm legislation.

RECOMMENDATIONS

As the first concession, developed countries should update their subsidy notifications through 2014 and commit to limit their amber box subsidies to the highest annual level actually paid out in the years since the launch of the Doha Round.

As the second concession, the United States and the European Union should commit over the next five years to reduce their overall trade-distorting support (OTDS) by at least 70%, as recommended during the Doha negotiations in July 2008. Such a cut would reduce the US OTDS cap from US\$48 billion to US\$14 billion.¹³

As for major developing country exporters of agricultural members, listed in table 2, they should commit to limit the maximum level of amber box subsidies to no more than 10% of agricultural production within 10 years.

Non-Agricultural Market Access

NAMA issues, as they are known, are considerably less controversial than agriculture issues. The biggest debate, still alive when negotiations were effectively adjourned in 2008, was the reluctance of major developing countries to reduce their bound tariff rates closer to their applied tariff rates for manufactured imports. US and EU firms also complained that the formulas applied to calculate tariff cuts only served to reduce bound rates, not the lower applied rates of most emerging countries. (For developed countries, bound and applied rates are generally identical.)

Table 4 shows pre-Doha and the provisionally agreed post-Doha tariff averages for six major economies, both bound and applied rates with respect to NAMA. The post-Doha bound rate provisionally agreed by Brazil is 12.4%, versus its applied rate of 5.9%. For India the comparison is 11.6% versus 7.7%. For others, the contrast is less sharp and for China it is practically non-existent.

11 See Schnepf (2014).

12 In 2012, the US AMS was US\$6.86 billion.

13 See, "Lamy Draft Modalities Outline would have entailed major US concessions," *Inside US Trade*, 1 August 2008, p. 7.



Table 4 | Pre-Doha and Post-Doha Weighted Average Tariffs for NAMA

	Pre-Doha		Post-Doha	
	Bound rate	Applied rate	Bound rate	Applied rate
European Union	2,4%	1,5%	1,2%	0,8%
Japan	5,7%	0,9%	1,9%	0,5%
United States	4,2%	1,4%	1,6%	0,7%
Brazil	30,3%	7,0%	12,4%	5,9%
China	4,1%	3,5%	2,9%	2,6%
India	30,4%	7,8%	11,6%	7,7%

Source: Hufbauer, Schott, Wong (2010)

Applied tariff rates for manufactured goods are generally low, but as table 4 shows, average applied rates imposed by key emerging countries are substantially higher than those imposed by major developed countries.

In an effort to “rebalance” a lopsided NAMA deal, the developed countries tried to promote multilateral sectoral agreements covering trade in a number of areas: services, chemicals, information technology, and environmental goods. As multilateral agreements, none of these got off the ground, but with the exception of chemicals, all of them are now the subject of plurilateral talks. Three plurilaterals – the Information Technology Agreement 2 (ITA2), the Environmental Goods Agreement (EGA), and the Trade in Services Agreement (TiSA) feature prominently agreements that should be concluded either in the run-up to the Nairobi Ministerial or in 2016. These are discussed in the next section.

RECOMMENDATIONS

WTO members should accept the tariff schedules provisionally agreed in the 2008 WTO talks, even though those schedules allow considerable “water” between bound and applied rates for emerging countries, and even though applied rates are generally higher in emerging countries than in the Organization of Economic Cooperation and Development (OECD) area. The logic of global value chains will encourage BRICS to continue the path of unilateral liberalization that most have pursued over the past two decades.

For sectoral liberalization, plurilateral talks now underway and future talks that might be launched (for example on chemicals) are the best approach. Plurilaterals on information technology and environmental goods already involve major trading nations and, as a practical matter, will “top up” whatever liberalization is achieved through the NAMA talks.



Services: Work in Progress

WTO negotiations on services began in 2000 as mandated under Article XIX of the General Agreement on Trade in Services (GATS) and soon after were integrated into the single undertaking of the Doha Round. Despite their head start, however, the WTO services negotiations are stalled closer to the starting line than the finish line. It is hard to conceive of a balanced WTO package that does not provide for significant services reforms over time, so progress on services is critical to the near-term success and long-term viability of the WTO.

In the Doha Round, services negotiations were focused on both liberalization and new rule-making in four major areas: market access; domestic regulatory policies; safeguards, government procurement, and subsidies; and special treatment for LDCs. For the most part, Doha negotiators gave short shrift to this part of the agenda, arguing that modalities on agriculture and NAMA had to advance before progress on services. Oddly, officials ignored the fact that services reforms would redound to the benefit of users of services in their economies as well as exporters of services, and that the availability of better and more cost effective transport, telecommunications and financial services, to name just a few, could generate substantial productivity gains for domestic farmers and industrial firms. Instead, services talks languished. The chair of the services negotiating group reported in May 2008 that 71 countries had submitted initial offers. But most offers echoed existing GATS bindings; in some cases, these offers did not even commit to maintain the current level of openness for trade and investment in services. Talks on new rules fared no better. The only area of progress has been the agreement at the 8th Ministerial Conference in December 2011 to adopt a waiver that allows WTO members to give preferential treatment to services from LDCs.

Because of the inaction in the Doha Round, a group of WTO members launched talks on a Trade in Services Agreement (TiSA). These negotiations are proceeding on a plurilateral basis outside of the WTO. That train should not slow to pick up all the WTO passengers. In the following section, we assess the progress in the TiSA talks and recommend that negotiators give a big push to completing those talks in 2016.

RECOMMENDATIONS

WTO members should refocus on services negotiations and strive to upgrade offers to liberalize their services trade. Recognizing that this will take some time, countries should commit at the Nairobi Ministerial to support a WTO waiver for the TiSA when that deal is completed.

Duty-Free Quota-Free Market Access

Recalling the decision at the 2005 Hong Kong Ministerial, the 2013 Bali Ministerial renewed the call for developed countries to provide DFQF market access for LDCs on 97% of their tariff lines. The Bali decision also called on developing countries, that so decide, to improve their own DFQF market access for LDCs.

Limited progress has been made on DFQF access since 2005. One problem is that the 97% threshold, while seemingly generous, allows developed countries to exclude a handful of tariff lines that account for a large share of LDC exports (Elliott 2010). Another problem is that tight rules of origin serve to exclude LDC exports that contain significant inputs from intermediate suppliers like China. A third



problem is that some countries have not stepped up with their own DFQF programs. Brazil and Russia have announced DFQF programs, but they have thus far implemented nothing. China, India, and Turkey have their own versions of DFQF, but generally less coverage than 97% of tariff lines. The United States and Korea are the only developed countries that have not met the 97% threshold.¹⁴

RECOMMENDATIONS

Developed countries should supplement the 97% threshold with a value threshold requiring that at least 75% of LDC exports qualify for DFQF. As less than 1% of global exports come from LDCs, this policy could have a major effect on the poor, and would have very little influence on the implementing countries (Elliott 2010). Additionally, the rules of origin should permit at least 30% of export value to originate outside of LDCs – a share that gives some recognition to the importance of global value chains. Finally, emerging economies whose merchandise exports exceed some threshold, say US\$200 billion annually, should meet the same DFQF standards as developed countries. This threshold would cover China, Russia, Mexico, India, Brazil, and Malaysia (see table 5).

Table 5 | Top 20 Merchandise Exporters, Developing Countries, 2012

	Global Exports (\$ bil)
China	2049
Russian Federation	525
Mexico	371
India	337
Brazil	243
Thailand	230
Malasia	229
Indonesia	190
Turkey	153
Vietnam	115
Kazakhstan	92
South Africa	87
Argentina	81
Chile	78
Algeria	72
Colombia	60
Romania	58
Belarus	46
Peru	46
Oman	46

Source: World Bank WITS

¹⁴ Kimberly Elliott gave useful comments on DFQF.



Information Technology Agreement 2

The original Information Technology Agreement (ITA), which was signed by 29 WTO members in 1996, phased out tariffs on imports across a wide array of high-tech goods. These goods are largely clustered within four two-digit Harmonised System (HS) categories: 70 (glass and glassware), 84 (machinery and mechanical appliances), 85 (electrical machinery), and 90 (measuring devices). Initially the ITA countries accounted for roughly 80% of world trade in the scheduled products. However, membership in the agreement has expanded substantially since 1996, and with the entry of Russia in September 2013, the ITA now includes 78 members, covering roughly 97% of world trade in the scheduled products.¹⁵ Large IT markets that remain outside the ITA include Brazil, Mexico, Tunisia, South Africa, Argentina, and Chile. Initially, the ITA's membership was composed almost entirely of high-income countries, but countries that joined after 1996 were primarily middle income or lower. As of 2014, 35 of the 77 ITA members can be categorized as middle income or lower.

It should not be surprising that countries of differing income levels have been quick to accept liberalization in the information technology field. In addition to serving as inputs for domestic goods, information technology brings huge productivity gains to the economy across a wide range of sectors and levels of development.¹⁶ Even for governments inclined to pursue import substitution, the benefits flowing from state-of-the-art IT imports are readily apparent.

Changing demographics in the ITA's membership reflect changes in global IT trade. Total trade in IT products tripled between 1996 and 2014, reaching US\$4 trillion, exceeding trade in agricultural and automotive products.¹⁷ More striking is the rapid rise of China, which exported more IT products in 2010 than its total exports of goods and services in 1999, measured in real terms.¹⁸ In fact, China was the world's largest exporter of IT products and the largest in terms of total trade in 2010, surpassing the European Union as a whole.¹⁹

While the prospect of bringing Mexico, Brazil, and other non-members into the ITA would benefit all countries, extending the commitments of current members could lead to far greater gains. Existing ITA members already encompass the vast majority of IT trade, so additional liberalization in terms of number of products and depth of commitments would deliver major gains. Current commitments do not encompass all IT products, nor do they eliminate non-tariff barriers that curtail trade in products already subject to tariff commitments. Talks have been held for more than a decade to expand the ITA in these dimensions, but not much progress was made until a breakthrough accord was reached between the United States and China in November 2014.²⁰

15 See, "Russia joins WTO's Information Technology Agreement," 2013 WTO News Items, 13 September 2013, World Trade Organization, www.wto.org/english/news_e/news13_e/ita_13sep13_e.htm.

16 Jorgenson, Ho, and Stiroh (2007) found clear links between the production and use of IT products for US growth (www.newyorkfed.org/research/current_issues/ci10-13/ci10-13.html); and Jorgenson and Motohashi (2005) found a similar effect in Japan.

17 USTR News, 10 November 2014

18 See "The WTO's Information Technology Agreement (ITA)," Information Centre, http://www.wto.org/english/news_e/brief_ita_e.htm and the WDI.

19 In 2010 China's IT exports reached US\$387 billion, compared with US\$267 billion for the European Union, the second largest exporter. China's IT imports were US\$292 billion, while the EU imported US\$387 billion worth of IT products. The United States was the third largest in both imports and exports, with US\$134 billion in exports and US\$222 billion in imports in 2010.

20 USTR News, 10 November 2014. The breakthrough was previewed on 8 October 2014, by Chinese Deputy Finance Minister Zhu Guangyao speaking at the Peterson Institute. See *Washington Trade Daily* 23, No 201. 9 October 2014.



The US-China accord was concluded in the margins of the APEC Summit held in Beijing. The USTR News release claimed that the new agreement, which covers more than 200 additional tariff lines, would eliminate tariffs on roughly US\$1 trillion of trade and increase global GDP by US\$190 billion, in the process supporting an additional 60,000 US jobs. The extended coverage reaches medical equipment, GPS devices, video game consoles, computer software and next generation semiconductors.²¹ However, despite the high spirits expressed at the time, other countries (particularly Taiwan and South Korea) are dissatisfied with China's updated offer. Of particular concern are Chinese tariffs on flat panel displays, particularly organic light-emitting displays (OLED).

Products Covered by the ITA. The ITA, as expanded by ITA2, covers a relatively broad set of products at a relatively detailed level. Generally speaking, the products fall within the following categories:²²

- Computers
- Semiconductors
- Semiconductor manufacturing equipment
- Telecommunication apparatus
- Instruments and apparatus
- Data-storage media and software
- Parts and accessories

Attachment A of the existing Agreement covers 190 products, which fell within 154 HS1996 subheadings (that is, six-digit HS codes), with 95 of those subheadings being fully liberalized by the participants. Since much of attachment A applies to tariff lines below the common HS6 level, different national governments can rely on different categorizations, leading to some products being treated differently by different ITA members.

Attachment B of the existing Agreement identified some of its products by a word description, rather than an HS code. As a result, different countries can opt to liberalize the same item in Attachment B using different HS codes. Repeated revisions to the HS codes have complicated matters further by mixing tariff lines covered under the ITA with some that were not.

The ITA2, when concluded by all members of the plurilateral talks, will add more than 200 new tariff lines (six-digit HS codes) and it should standardize the commitments under attachment B. Moreover the ITA2 commitments should define covered goods in terms of the latest HS

²¹ The agreement took a long time to reach because China's initial offer was unacceptable to the United States, the European Union, and Japan. Of the 250 tariff lines slated for liberalization, China indicated that roughly 140 were considered highly sensitive. In the Chinese proposal, half of those tariffs would have been phased out over relatively long time frames (often beyond five years), while the remaining half would have been excluded. Extended phase out periods are considered particularly burdensome in the IT sector, since new products could quickly render older ones obsolete. A particular sticking point was the semiconductor industry, a key intermediate product in China's burgeoning IT export industry, and an area where US firms are highly competitive. All these differences were resolved in the margins of the APEC Summit in November 2014.

²² Drawn from WTO (2012).



nomenclature (HS2012) and “round off” the HS2012 subheadings that are only partially covered by existing ITA commitments.

Expanded Coverage: In 2012, the USTR filed a request with the United States International Trade Commission (USITC) seeking analysis of the proposed expansion to the ITA. The request included a list of proposed products submitted by parties. As with the original ITA, ITA2 products are classified by HS code (now HS 2007, which was current at the time) or by a broader description in attachments A and B, respectively. Products listed in attachment A fall within 357 6-digit HS codes. However, many of these products are “ex outs”, offering only partial coverage of the 6-digit item. The USTR’s request to the USITC noted that the proposed update is not intended to alter commitments or rights under the original agreement. However, some products that are already covered under the original agreement are included in the USTR’s proposed list, largely for HS codes that have been mangled through successive generations of HS codes. Table 6 displays the imports and tariffs of some major ITA participants in the latest available year for all 6-digit HS codes covered in whole or in part in the proposed attachment A. The total for these five participants (four countries and the European Union) was about US\$1.2 trillion in imports. “Ex out” items accounted for about one-third of total lines and one-sixth of total trade, so imports of entirely covered products was just over US\$1 trillion. Lastly, some products already overlap with ITA commitments or have zero tariffs among many participants. If items that are duty free for both the United States and European Union are excluded, as well as the “ex out” items, covered imports still totaled US\$600 billion.

Table 6 | Trade in ITA2 Products

	Imports (billions USD)	Average Tariff
China	459	7,7%
EU	246	0,9%
Japan	107	0,1%
Korea	85	3,7%
US	331	0,7%

Includes imports imports of all 6 digit HS items listed, in whole or in part

Work Ahead: Non-Tariff Barriers. As mentioned above, the original ITA and now the ITA2 reduce and even eliminate tariffs that apply to selected goods. However, non-tariff barriers (NTBs) still place significant drags on global IT trade, even among ITA members. Initially there was pressure to discipline some NTBs in the ITA, but eventually members decided to limit the extent of ITA commitments to tariffs, hoping to make the agreement acceptable to more countries. Specifically, the European Union had favored including some coverage of NTBs, while the United States preferred a tariff-only agreement.²³

The original ITA did acknowledge that NTBs were a serious concern in IT trade and laid the groundwork for future progress in this area. The agreement called for the establishment of a work program on NTBs, and identified measures that impeded trade in products covered by the ITA.²⁴

23 See World Trade Organization, “Ministerial Declaration on Trade in Information Technology Products,” http://www.wto.org/english/docs_e/legal_e/itadec_e.htm. For more on European views, see “Informal talks set to begin on expanding the Information Technology Agreement,” 2012 WTO News Items, World Trade Organization, 15 May 2012, www.wto.org/english/news_e/news12_e/ita_15may12_e.htm.

24 “ITA Committee approves work programme on non-tariff measures,” Press Release, World Trade Organization, 17 November 2000, www.wto.org/english/news_e/pres00_e/pr198_e.htm.



Members issued a series of communications; some of which highlighted the NTBs believed to be problematic, while others responded to specific questions about the types of NTBs that their government imposed. The Annex to the agreement stated that participants should meet regularly in order to consult on the status of NTBs, although not much progress has been made in recent years.²⁵

The IT sector is subject to various NTBs, with the following being the most prominent (Hufbauer and Schott, 2013):

- Conformity assessment, testing and certification procedures
- Standards and environmental regulations
- Customs procedures and certificates of origin
- Import licensing
- Rules of origin
- Transparency and availability of information
- Government procurement
- Restrictions on IT professionals

Despite providing ample encouragement for members to resolve NTBs, the agreement did not mandate specific goals. Some NTBs might be tackled in other WTO pacts, such as NAMA, within the “electrical and electronics” sector. However, most observers doubt that NAMA commitments in IT could substitute for a dedicated update of the ITA.²⁶

RECOMMENDATIONS

ITA2 should be a major “deliverable” at the Nairobi Ministerial. This can be accomplished if China, Taiwan and Korea will agree on product coverage. Looking to the future, beyond Nairobi, further liberalizing IT products by addressing NTBs holds considerable promise. Given the recent breakthrough on tariff liberalization, the potential for NTB reform is limited at the moment. However the relevant portions of the upcoming mega-regional agreements (TTIP and TPP) might be “multilateralized” if and when those agreements are successfully implemented. This approach would add considerable heft to the ITA2 accord. Since China, the European Union, and the United States are the three biggest importers and exporters of IT products, an agreement on NTBs will require the active support of all three powers.

25 WTO, Committee of Participants on the Expansion of Trade in Information Technology Products, Minutes of Meeting on 14 October 2013.

26 “EU pushes for ITA expansion, Russia wishes to join,” WTO News Items, World Trade Organization, 24 October 2011, www.wto.org/english/news_e/news11_e/ita_24oct11_e.htm.



POST NAIROBI GOALS 2016

At Nairobi, WTO Director-General Roberto Azevedo, along with ministers, should declare their commitment to wrap up two on-going plurilateral negotiations in 2016, and bring them into the WTO framework. The two plurilaterals that are ripe for completion within a year are the Environmental Goods Agreement (EGA) and the Trade in Services Agreement (TiSA).

Environmental Goods Agreement²⁷

After years of unproductive Doha Round talks, in July 2014, 14 WTO members, including the United States, European Union, and China, committed to negotiate a plurilateral agreement, dubbed the EGA, to liberalize environmental goods trade through tariff elimination.²⁸ Iceland, Israel, and Turkey subsequently joined the talks in 2015. Once the EGA is accomplished, we recommend that the original countries, and others, return to the negotiating table to conclude an augmented agreement, EGA-plus.

While the level of ambition of the current EGA talks is uncertain, but seems modest, the talks started with the 54 product groups adopted by APEC for voluntary liberalization. Apparently the EGA talks are tackling these product groups incrementally, cluster by cluster – for example, air pollution equipment, wastewater equipment, etc. In March 2015, negotiators agreed on finalizing an introductory list of around 600 products in 10 categories.²⁹ USTR estimates that global environmental goods trade, broadly defined, could be worth US\$955 billion annually.³⁰ Even if modest, a successful EGA will promote faster deployment of green technologies at a time when the renewable energy sector is becoming more competitive relative to fossil fuels. However, significant challenges must be addressed.

Established technologies, like hydropower and geothermal are almost fully competitive with fossil fuels while onshore wind and solar photovoltaic energy are on their way. To speed the process, developed and developing countries are implementing green policies – feed-in tariffs, cash subsidies, and tax and investment incentives fostering renewable energy production, in particular wind and solar. Foremost in political calculations behind these policies are hopes of creating domestic manufacturing capacity and jobs. This is where tariff and non-tariff barriers come into play, as a means to advantage domestic firms over their foreign competitors.³¹

The Problem. Given this background, it's not surprising that penalty duties imposed through trade remedy proceedings, namely anti-dumping (AD) and countervailing duties (CVD), as well as local content requirements (LCRs), have become increasingly popular in the renewable energy space.

27 This section paraphrases Cimino (2014), which in turn draws heavily on Cimino and Hufbauer (2014a). Jisun Kim gave useful comments for this section.

28 The 14 members are Australia, Canada, China, Costa Rica, the European Union, Hong Kong, Japan, Korea, New Zealand, Norway, Singapore, Switzerland, Chinese Taipei, and the United States.

29 Washington Trade Daily, Vol. 24 No 59, 24 March 2015. The number of membership changed after Iceland, Israel and Turkey joined.

30 See "US Trade Representative Froman, Fellow Trade Ministers Plan New Talks Toward Increased Trade in Environmental Goods," Press Release, Office of the US Trade Representative, January 2014, www.ustr.gov/about-us/press-office/press-releases/2014/January/Froman-ministers-launch-new-talks-toward-increased-trade-environmental-goods.

31 Underlying the use of such measures is the "political reality that high financial support for renewable programs might not be publicly supported if there were no local benefits attached" (Kuntze and Moerenhout 2013, 34).



By our count, over 40 AD and CVD cases have targeted renewable energy products since 2008 (Cimino and Hufbauer 2014a). Stephenson (2013) reports that more than 20 LCRs have impacted the renewable energy sector as part of broader government mandates.

These measures have prompted high-profile trade conflicts between some of the largest producers of renewable energy, most notably China, India, the European Union and the United States. The conflicts may erode the competitiveness of renewable energy and undermine efforts to mitigate climate change. One challenge for an EGA-plus accord is to moderate the adverse effects of trade remedies. We first outline the problems created by LCRs and then address penalty duties.

LCRs in Renewable Energy. Localization policies mandate that domestic suppliers of goods, services, or entire projects be favored not only by governments but also by private firms. Many renewable projects are financed in whole or part by public funds, and this makes them a ready target for LCRs. The political argument is that government money should support local jobs.

LCRs have thus proven popular in renewable energy projects but they are generally bad policy. The protective effect of LCRs can be highly variable and opaque; the cost impact on downstream producers is often difficult to calculate; LCRs can create delays and increase overall project costs; and they are seldom constrained by sunset clauses, meaning their effects are long-lasting (Hufbauer and Schott 2013). The cited study found that over 100 LCRs have been proposed or implemented in the past five years and could have reduced global trade by around US\$90 billion. A small, but growing portion of LCR cases target renewable energy specifically.

LCRs often serve as preconditions attached to government support schemes, like feed-in-tariffs and subsidies for wind and solar energy. For example, to qualify for subsidies under India's Jawaharlal Nehru National Solar Mission (JNNSM) program, solar developers must use cells and modules manufactured in India. Brazil requires manufacturers of wind turbines to locally source 60% of their components.³² LCRs may boost domestic production in the short term under specific circumstances, but LCRs more often insulate domestic firms from competition, dampening incentives for innovation and reinvestment in research and development.³³

LCRs in the renewable energy sector were first formally disciplined in 2013, when the WTO dispute settlement body ruled that the use of LCRs by Canada in the wind sector violated the WTO obligation to ensure national treatment for foreign firms. The United States is now challenging the use of LCRs in India's JNNSM program after failed consultations. Other cases now underway challenge the use of LCRs attached to support schemes in the European Union and in China. But the gaps in the current WTO rulebook, along with the fact that WTO dispute procedures are both time-consuming and costly, have slowed the pace of legal challenges to LCRs.

Proposed Disciplines for LCRs. Perhaps the most direct way to constrain the use of LCRs in renewable energy is through a code of good practice that serves as a binding plurilateral agreement within the WTO. Current multilateral rules have had limited effectiveness on curbing

32 See "Brazil: BNDES increases local content requirement for wind turbines: Measure #5919," *Global Trade Alert*, 1 February 2014, <http://www.globaltradealert.org/measure/brazil-bndes-increases-local-content-requirement-wind-turbines> (accessed on 30 June 2014).

33 Among recent studies, see Lewis and Wisser (2007); Rivers and Wigle (2011); Kuntze and Moerenhout (2013); and Stephenson (2013).



the use of LCRs primarily for three reasons: gaps in the rules, weak surveillance mechanisms, and inadequate enforcement.³⁴

Among other new issues, we signal the need for an LCR Code covering all sectors, but this would be an ambitious undertaking. The EGA-plus could break the ice by setting parameters on the use of LCRs in renewable energy. Proposals include setting a time limit on current localization policies and moratorium on the use of LCRs in future projects (Stephenson 2013). Eventually all government procurement and funding of renewable energy should be open to members of the EGA-plus pact. These disciplines could initially be linked to the schedule of environmental goods agreed for tariff-free treatment in the EGA. In other words, under EGA-plus, LCRs otherwise enforced by signatories would not apply to scheduled environmental goods supplied by members of the agreement.

Trade Remedies in Renewable Energy. Antidumping (AD) and countervailing duty (CVD) procedures were developed to allow the imposition of penalties against foreign firms when it can be proven that a domestic industry suffers “material injury” from either price discrimination, the dumping of products in a foreign market at a price “less than fair value,” or from subsidies that provide unfair advantages to domestic firms. While originally developed to level the playing field against “unfair” trade practices, it has become common practice to use AD and CVD measures as means to protect domestic firms incurring even a small degree of “injury,” regardless of the objective “fairness” of imports, and regardless of counterbalancing considerations, such as climate change.

A survey of recent cases shows that more than 40 AD and CVD cases have targeted renewable energy products since 2008 (Cimino and Hufbauer 2014a). A core group of countries are at the center of renewable investigations, including Australia, China, the European Union, India, and the United States. Solar energy products are targeted by 18 of the cases, or 44% of the total, covering solar-grade polysilicon, solar cells, and solar glass.

Some 16 cases target biofuels, namely biodiesel and ethanol, with particular relevance to Latin American countries both as complainant and respondent countries. In mid-2010, Peru imposed specific duties on biodiesel imports from the United States, namely an AD duty of US\$212 per ton and a CVD of US\$178 per ton. In November 2013, the European Union imposed AD duties on biodiesel imports from Argentina ranging from €237.0 to €245.6 per metric ton. Argentina has separately requested consultations in the WTO regarding both EU anti-dumping procedures and biodiesel support schemes.³⁵

Based on the collective AD and CVD penalties imposed, the authors estimate that the total reduction of trade from 41 cases could be about US\$14 billion annually.³⁶ Since penalty duties are effective for five years, pending the sunset review, the annual figure translates to a global trade loss of almost US\$70 billion over five years.

34 The WTO rulebook consists of various provisions that seek to discipline LCRs, found within the General Agreement on Tariffs and Trade, the Government Procurement Agreement, Trade-Related Investment Measures, and the Agreement on Subsidies and Countervailing Measures. These are too extensive to outline here, but see Cimino, Hufbauer and Schott (2014) for more detail.

35 The cases are ongoing but have not proceeded to the WTO panel stage. For a summary, see “European Union and Certain Member States — Certain Measures on the Importation and Marketing of Biodiesel and Measures Supporting the Biodiesel Industry,” Dispute Settlement: Dispute DS459, World Trade Organization, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds459_e.htm (accessed on 30 June 2014); and “European Union — Anti-Dumping Measures on Biodiesel from Argentina,” Dispute Settlement: Dispute DS473, World Trade Organization, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds473_e.htm (accessed on 29 June 2014).

36 For detail on methodology, see Cimino and Hufbauer (2014a).



Proposed Disciplines for CVDs. For practical reasons, we do not propose limits, in the EGA-plus pact, on anti-dumping duties. Time and again, experience has shown that AD provisions in the WTO (GATT Article VI) and domestic laws (particularly in the United States) are impervious to reform. There seems little point in fighting the same battle over environmental goods.³⁷

However, CVDs might be amenable to limited reforms. The conceptual argument is simple and powerful. Most subsidies distort trade. By contrast, subsidies to environmental goods, particularly renewable energy, *offset* the distortions inherent in the absence of pollution charges, particularly charges on CO₂ emissions.³⁸

Disciplines on CVDs against renewable energy goods, and perhaps other environmental goods as well, could take shape as part of the plurilateral EGA-plus pact. To summarize, promising reforms include: (1) limiting CVD penalties through the lesser duty rule, whereby a countervailing duty is levied only at a rate sufficient to remove the injury inflicted on the domestic industry; (2) shortening the current allowance of CVDs, namely five years, to a shorter period, say three years; and (3) mandating a public interest test before the imposition of CVD penalties.³⁹

Other Disciplines. Without overloading the pact, three additional subjects could be the subject of exploratory committees established by the EGA-plus signatories. One subject concerns technical barriers in the form of standards and labeling requirements that differ between countries and thus obstruct market access. The signatories could usefully examine the feasibility of mutual recognition and harmonization approaches. A second subject concerns restrictions on foreign investment in renewable energy projects. Such restrictions obviously retard the spread of frontier technology. A third subject concerns best practice incentives to stimulate new ideas and faster deployment. On this subject, the members have much to share on what works, and what doesn't, within their own countries. Additionally, the World Bank can shed light on promising approaches for developing countries.

Potential Gains. The gains from an environmental goods agreement would largely depend on the level of ambition of the agreement. Both the number of goods covered and the depth of liberalization could fall across a substantial range. The "APEC list" of environmental goods consists of several dozen products, while the "WTO list" exceeds 400 products. An EGA-plus agreement would probably not tackle all of the non-tariff barriers described earlier in this section, but it would make a start. Table 7 gives the relevant tariff and NTBs faced by exporters.

37 Among other defenses, trade remedies, especially ADs, are seen as offering "a much faster, direct, and politically popular means of response to unfair industrial policies compared to WTO disputes" (Wu and Salzman 2013, 50).

38 For a persuasive argument, see Cosby and Mavroidis (2014).

39 For these and other proposals, see Lester and Watson (2013); Wu and Salzman (2013) and Kasteng (2013).



Table 7 | Average Barriers to Trade in Environmental Goods by Country Classification

	Average Tariff Rate	Tariff Equivalent of total protection (tariffs+NTBs)	Imports (\$ billions, APEC list)	Projected increase in imports from a 25% reduction in total barriers (\$ billions) ¹
High Income	3%	6%	264	14,297
Upper Middle Income	7%	11%	154	7,884
Lower Middle Income	6%	27%	19	1,928
Low Income	7%	45%	2	241

Source: Melo and Vijil, 2014 and authors' calculations

¹ Using elasticities for each income group given by Melo and Vijil

Overall, a relatively modest EGA would deliver similarly modest gains. Eliminating one quarter of tariffs and NTBs should increase trade in environmental goods by roughly 6%, equal to about US\$24 billion, based on the APEC list and 2013 trade levels. While this is small compared to some of the other possible pacts dealing with new issues, any increase in environmental goods has the added benefit of reducing local pollutants as well as greenhouse gasses. Moreover, larger production of environmental goods in competitive countries will lower average costs due to scale, and promote further research. These spillover effects are not captured by the US\$24 billion export figure. Finally, a modest EGA-plus agreement in 2015 or 2016 could lead to a more ambitious agreement in future years.

Trade in Services Agreement⁴⁰

A plurilateral Trade in Services Agreement (TiSA) is by far the most important plurilateral pact among the new issues. Launched by the Really Good Friends (RGF), a group of WTO members that opened negotiations in 2012, the group includes the world's largest advanced nations, accounting for more than two-thirds of global trade in services (Hufbauer, Jensen, Stephenson 2012).

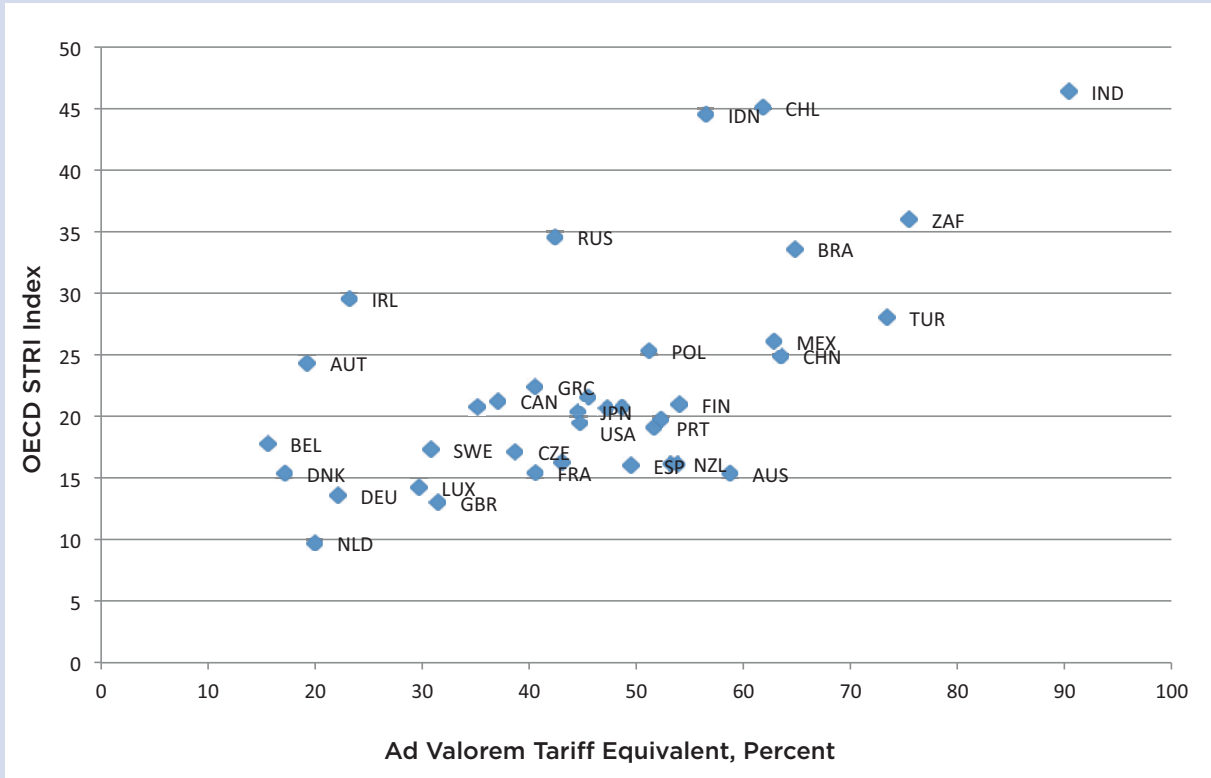
As figure 1 shows, whether measured by the OECD's Services Trade Restrictiveness Index, or by CEPII's calculations of *ad valorem* tariff equivalents, national average barriers to services trade are highly restrictive, often with tariff equivalent rates of 40% or higher. Motivated by the longstanding stalemate in addressing services in the Doha Round and inspired by the business community, which encounters the high barriers and appreciates the importance of service inputs, the negotiations seek to augment GATS and further liberalize services trade among TiSA members.

The TiSA negotiation is not a part of the Doha Round, which dropped the ball on services. Instead TiSA is a plurilateral effort designed, in the first instance, to meet the conditions laid out in GATS Article V. To meet the tests of Article V an agreement is required to achieve "substantial sectoral coverage" with respect to the volume of services trade, number of sectors, and modes of supply, and to eliminate "substantially all discrimination" among its members.

⁴⁰ This section draws heavily on Chapter 7 in Bergsten, Hufbauer and Miner (2014).



Figure 1 | CEPII AVEs and the OECD STRI



Source: Fontagne, Guillin, Mitaritonna (2011), OECD (2014).
 Ad valorem equivalents estimate the cost of trade restrictions as a percent of the price of the good or service being sold. The OECD's STRI measure's the restrictions a country's legal code places on the services trade, but it does not estimate a price effect.
 Numbers above represent simple averages of the sector estimates given in the sources. The STRI, reported on a scale of 0 to 1, has been scaled up to a scale of 0 to 100

EU Proposals. A “non-paper” circulated by the European Union proposes that the architecture of TiSA should start with a “central pillar” of obligations drawn from the General Agreement on Trade in Services (GATS).⁴¹ Attached to the “central pillar” would be schedules of obligations committed by TiSA members in some 14 individual sectors.⁴² When the obligations are accepted by countries that account for a “critical mass” of services trade in the sector, the rights in that pillar would be extended on an unconditional basis to all WTO members.

China, the BRICS, and TiSA. China expressed its interest in joining TiSA negotiations in September 2013, and the United States and other TiSA members are still considering their response.⁴³ While

41 See “The EU publishes TiSA position papers,” News archive, 22 July 2014, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1133>.
 42 The 14 sectors identified by the EU are: business services, communication services, construction services, distribution services, education services, environmental services, financial services (includes insurance), health services and social services, tourism and travel-related services, recreational, cultural and sporting services, transport services, services auxiliary to transport, other transport services, and energy services.
 43 Shawn Donnan, “China in Push to Join US-led \$4tn Services Trade Talks,” *Financial Times*, 23 September 2013, www.ft.com/intl/cms/s/0/864744ec-21eb-11e3-bb64-00144feab7de.html. US acceptance of China as a TiSA member is partly conditioned on China's willingness to conclude the Information Technology Agreement 2 (ITA2). The US position exemplifies a linkage between two plurilateral agreements.



China's interest could be driven by a fresh appreciation that services imports support manufacturing and improve the quality of life, it might also reflect China's rising competitiveness in some services industries, reflecting the nation's educational attainments.

Before China's change of heart in 2013, all five BRICS – Brazil, Russia, India, China, and South Africa – had shown little interest in a plurilateral agreement on services trade.⁴⁴ At the moment, the other BRICS remain skeptical. These countries account for a large portion of the one-third of international services trade that current TiSA members do not cover. As figure 1 shows, the BRICS tend to have relatively high barriers to services imports, whether measured by CEPII's *ad valorem* equivalents (AVEs) or by the OECD's Services Trade Restrictiveness Index (STRI).

Bringing the BRICS into TiSA could lead to substantial gains. With that in mind, the EU proposal mentioned above draws on core features of the GATS to make the TiSA familiar to developing members of the WTO.

Sticking Points. TiSA negotiations are still at an early stage, so exactly what the agreement will cover is not clear. However, some features are emerging. While GATS applied a positive list approach to schedule commitments for services trade, TiSA is moving towards a hybrid approach.⁴⁵ Members will still schedule market access commitments under the positive list approach, but national treatment obligations will be handled under a negative list approach, in which members commit to national treatment in all sectors except for those where an exception is scheduled.

The positive list approach for market access could present problems going forward as new services are created. These new services would not have been listed, so TiSA's market access provisions would not apply to them. Even under a negative list approach disagreements could arise about how to categorize them. For newly created services, it seems almost inevitable that conflicts will necessitate future negotiations.

In April 2014, TiSA members circulated their first round of offers of market access concessions, and in June 2014, they circulated their second round of offers. They held a third round in September 2014 and a fourth round in December 2014 for market access talks. The latest fifth round was held in February 2015. Apart from the European Union, which published its proposed concessions on the internet, other countries have not disclosed their offers, but some US proposals were leaked. As a starting benchmark, members are offering the most liberal terms contained in their free trade agreements. Thus whatever is concluded in the Trans-Pacific Partnership (TPP) will serve as a benchmark for TiSA members that are also TPP members (notably Australia, Canada, Japan and the United States).

Among the many potential sticking points, a few are worth calling out. One is the extent of coverage of service procurement and regulation by sub-federal governments. This is a difficult question for the United States, Canada and a few other federal countries where sub-federal bodies are responsible for professional accreditation, and where states, provinces, and cities are major purchasers of services ranging from health care to education to database management.

44 However, China signed a services agreement with Taiwan on 21 June 2013. See Cindy Wang, "China Signs Pact with Taiwan to Open Services Trade Sectors," *Bloomberg*, 21 June 2013, www.bloomberg.com/news/2013-06-21/china-taiwan-services-pact-signals-warmer-ties-after-llJJ2010-deal.html.

45 "US Proposes Alterations To TISA Text, Delaying Market Access Offers," *Inside US Trade*, 3 July 2013, www.insidetrade.com.



Another sticking point is shipping and air transport, fields in which the United States and a few other countries adamantly oppose the entry of foreign competitors into “cabotage” routes – namely point-to-point service within the country. The US Merchant Marine Act of 1920, commonly known as the Jones Act, bans all foreign vessels from participating in cabotage. The US government can issue waivers as it sees fit, but this power has only been exercised in emergency situations.⁴⁶ The United States applies similar cabotage restrictions to air traffic.

A third sticking point concerns the line between market access barriers to financial services (banking, insurance, real estate, stock and commodity markets, etc.) and regulatory standards that are designed to protect the public and taxpayers. In principle, market access barriers are a fit subject for negotiation, but in practice regulatory standards – which are usually off the negotiating table – can act as market access barriers. So the line is important.

Lastly, the issue of cross border data flows has become extremely tense in the wake of spying scandals surrounding the United States, United Kingdom, and other countries. Negotiators based in jurisdictions without strong ICT sectors could insist on retaining the flexibility to restrict data movements, both in the interest of privacy and as a means of fostering domestic ICT firms. The issue will become more controversial if US courts affirm the administration’s position that US firms can be compelled to surrender data stored outside the United States.⁴⁷

Potential Trade Gains. Since services account for more than 65% of private economic activity in most countries, but less than 25% of world trade, the potential trade gains from liberalizing barriers seem huge. The fact that measured barriers to services trade are high, compared to barriers on merchandise trade, reinforces the scope for potential gains (again, see figure 1).

One calculation illustrates the possibilities: US manufacturing firms directly export around 20% of their output compared to 4% for direct exports by service firms. If TiSA liberalization is sufficiently ambitious over a period of 5 to 10 years, the export-sales ratio in services might rise to 10% – half the figure for manufactures. At that ratio, service export gains would be substantial. OECD countries might see an estimated US\$720 billion in increased exports; of this amount, US exports would increase by nearly US\$300 billion.⁴⁸

Such large gains would require substantial liberalization and take years for structural transformation to be realized. However, TiSA should deliver notable short-term gains as well. Even a modest TiSA that leaves the majority of barriers intact could deliver meaningful results, since current barriers are high.

Table 8 reports estimates of the “static gains” associated with a moderately ambitious TiSA. Using the estimates of services barriers calculated by CEPII, we assume that a moderate TiSA would reduce tariff equivalent barriers in all sectors by one-fourth. We then use an assumed elasticity value of -1.3 to compute the percentage change in global exports of services, tabulated for each service subsector. Table 6 shows the calculated gains relative to 2012 trade, the latest year for reliable data. CEPII’s estimates cover some 65 countries, and our analysis assumes that all of those countries cut

46 For an example of such a waiver, see “Homeland Security grants waiver of Jones Act for Nome fuel delivery,” *Alaska Business Monthly*, 30 December 2011, www.akbizmag.com/Alaska-Business-Monthly/December-2011/Homeland-Security-grants-waiver-of-Jones-Act-for-Nome-fuel-delivery/.

47 A recent development in the case is described in the article, “Microsoft ordered to hand over emails on Dublin server,” *BBC News*, 1 August 2014, www.bbc.com/news/technology-28601788.

48 For further detail, see Jensen (2011); Hufbauer, Jensen, and Stephenson (2012); and Hufbauer and Schott (2013).



their barriers by one-fourth. Even though not all of these countries are currently participating in TiSA, the agreement will remain open to any WTO member willing to accede. The total gains calculated under this scenario come to US\$239 billion, roughly 10% above 2012 baseline exports.

Table 8 | Trade in Services and Gains with Liberalization of Services Barriers

	2012 level (\$ billions)	Projected Increase (\$ billions)	Projected Increase (Percent)
Communications	80	9	11%
Construction	62	9	15%
Finance	120	16	14%
Insurance	158	19	12%
Other Business	995	104	10%
Government	66	5	8%
Transport	930	77	8%

Source: Fontagne, Guillin, Mitaritonna (2011); ITC, Trade in Services



WTO AGENDA BEYOND 2016

The WTO cannot be content just to address the issues left over from the Doha Round and to wrap up the plurilaterals that are already steaming ahead (ITA2, EGA and TiSA). To maintain its relevance as a negotiating forum, the WTO must also address new issues which are uppermost in the mind of world traders and investors. In this chapter we examine six such issues – an illustrative rather than an exhaustive list – that could be included in a work program agreed at the 11th Ministerial to be held in 2017. The subjects we suggest should be incubated in plurilateral negotiations. But over time, WTO members should ensure that all the agreements evolve into multilateral accords:

1. Local Content Requirements
2. Investment Framework Agreement
3. Exchange Rate Practices
4. State-owned Enterprises
5. Export Controls
6. Digital Trade and Telecom Hardware

Before diving into the substance of these six possible issues, it is essential to lay out modalities for bringing them into the WTO's negotiating tent.

Negotiating Modalities

Open Plurilateral Agreements. None of the topics mentioned seems ripe at the outset for a multilateral accord, subscribed by all 161 WTO members. The issues are simply too contentious for reaching agreement on rules that would necessarily crimp the policies of many WTO members. But what might be possible are plurilateral agreements that would establish rules of the road just for signatory members. Each agreement under WTO auspices should, as a matter of principle, be open to any WTO member that later decides to join both to accept the obligations and enjoy the rights. Thus the first negotiating modality is broad acceptance of open plurilateral agreements.

Unconditional and Conditional MFN Terms. The concept of an open plurilateral agreement on almost any topic should prove acceptable to all WTO members, including non-signatories, if the *rights* under the agreement are extended, on an unconditional most-favored-nation (MFN) basis, to all WTO members. Who would object to enjoying rights with no obligations? Possibly a few WTO members might argue that they should have a place at the negotiating table where the agreement is designed, even though they are not immediately ready to accept the obligations. Hopefully these naysayers are not so numerous or powerful that they can block plurilateral accords with unconditional MFN terms.

A more serious problem arises for a plurilateral agreement that conditions the enjoyment of rights on the acceptance of obligations. Non-signatories may well object to such plurilateral agreements under WTO auspices, even when the agreements are open to later admission of WTO members that were not original signatories. Non-signatories will want a say on the terms of the agreement, and they will want to preserve their leverage to secure the consent of signatories to negotiations on unrelated issues. On the other hand, potential signatories will understandably refuse to extend valuable market access rights to countries that are unwilling to reciprocate.



We propose an answer to this conundrum. signatories to plurilateral agreements with a conditional MFN feature should not seek to incorporate those agreements into the corpus of the WTO. By the terms of Article IX (3) of the Marrakesh Agreement, incorporation would require a three-fourths affirmative vote of all members, and naysayers may well preclude approval.

Even though not part of the WTO, however, the plurilateral agreements should create their secretariats in Geneva. As explained in more detail below, the plurilateral members should be permitted to draw on the WTO's dispute settlement system to resolve their internal disagreements.

No Explicit Linkages. The concept of a “single undertaking” was a pillar of the Uruguay Round (1986-1994): it packaged the bargain to end quantitative restrictions on textiles and apparel trade with agreements on services and intellectual property. But the same concept proved debilitating in the Doha Round (2001-??) because no combination of accords has been found that can satisfy all WTO members.

In our view, the labored and unsuccessful experience of Doha Round talks shows that the “single undertaking” is no longer a useful modality. The interests of WTO members are too diverse, and no “steering group” of leading members can corral reluctant countries. More flexibility is needed both to finish the core work of the Doha Round on agriculture, NAMA and services, and to advance agreements among countries willing to deepen commitments on specific topics via plurilateral pacts in which the reforms can be extended solely to participating countries or to the entire WTO membership.

In sum, we conclude that WTO deals on agriculture and NAMA can only conclude if paired with substantive progress on services and the willingness of WTO members to accommodate new plurilateral pacts that only obligate signatory countries. Without such a two-pronged deal, we fear that there would not be sufficient political support in developed countries to ratify the substantial reforms in agriculture and NAMA that we recommended above. The way forward is step-by-step, agreement-by-agreement. Of course logrolling will occur between members of different plurilateral pacts: “You accept my position in pact A, and I'll accept your position in pact B.”⁴⁹ But explicit requirements to conclude two or more agreements as a single package should be avoided. Instead the goal – difficult as it is – should be to draft agreements that are self-balancing within their four corners.

Dispute Settlement. International commercial accords are seldom effective without efficient dispute settlement systems to fill in gray areas and deal with rule-breakers. As its premier achievement, the WTO established a first-class dispute settlement system, comprised of fact-finding panels and the Appellate Body.⁵⁰ Future plurilateral accords should ideally be adjudicated by this system, expanded as needed with additional Appellate Body members (there are now seven) and budget resources for more professional staff, paid for by the signatories to plurilateral agreements. As with existing WTO obligations, the plurilateral accords should set forth their own menu of remedies. These remedies should include the possibility of withdrawing rights either under the agreement in question, or another agreement; in addition, the possibility of monetary penalties should be explored.

49 Along these lines, the United States has insisted that China accept nearly all of the tariff lines agreed by other members of the expanded Information Technology Agreement (ITA2) as the “price” for Chinese admission into the Trade in Service Agreement (TiSA) talks.

50 Professor John Jackson deserves acclaim as the chief architect of the WTO's dispute settlement system.



Non-signatories should welcome the coherence of a single dispute settlement system for trade and investment issues. However, if non-signatories somehow block the extension of WTO jurisprudence to deal with plurilateral commitments, the signatories should create a new dispute settlement body for their own agreements, modeled after the WTO’s highly successful system.

Local Content Requirements⁵¹

Local content requirements (LCRs) grew like crabgrass in the wake of the Great Recession. Following the global economic crisis in 2008, protectionist policies became common practice despite broad pledges to curb new barriers to trade and investment (Evenett 2013). Even though they flaunt the spirit of multilateral agreements, LCRs have been challenged in only three cases brought in the WTO.

Put simply, LCRs are designed to ensure that domestic firms enjoy the role of preferred suppliers for goods, services, and even entire projects – even though foreign firms may offer lower costs, better quality, and faster delivery. According to our broad survey (Hufbauer et al. 2013), more than 100 LCRs have been proposed or implemented since 2008, by developed and developing countries alike, and these may have reduced global trade by about US\$93 billion annually (see table 9).

Table 9 | Estimated Goods and Services Trade Impacted by LCR Measures since 2008

LCR measure	Estimated affected goods and services trade (billions) ^a	Speculative estimate of trade reduced by LCRs (billions) ^b
47 quantifiable measures	373	37
70 non-quantifiable measures ^c	555	56
Total for 117 LCR measures	928	93

a Cumulative trade figure calculated from Hufbauer et al. (2013), Appendix A.

b As a conservative but speculative guess, we calculate reduced trade assuming an estimated tariff-equivalent of 10 percent ad valorem for LCRs and assuming the elasticity of import demand for foreign goods is approximately -1.0.

c For “non-quantifiable” LCR measures, the estimated affected trade was calculated by multiplying the 70 measures by the average of \$7.9 billion affected trade per “quantifiable” LCR measure.

Note: “Quantifiable” LCR measures explicitly target a subset of products which are traded internationally and could be identified by 4-digit HTS codes. By contrast, although most “non-quantifiable” LCR measures directly target trade flows, they could not be easily quantified, due to their opaque nature, vague wording or non-transparent application. See Appendix A for more detail.

Source: Hufbauer et al. (2013), table 3.1

Historically, LCRs have been associated with government procurement and mandates attached to publicly-financed projects. But LCRs can take many forms: price preferences awarded to domestic firms that bid government procurement contracts; mandatory minimum percentages required for the domestic goods and services used in production; import licensing procedures designed to discourage foreign suppliers; and discretionary guidelines that both encourage domestic firms and discourage foreign firms. They crop up across all industries, including agriculture, autos, and healthcare, but with notable frequency in energy and information technology.

51 This section is a highly condensed version of Cimino, Hufbauer, and Schott (2013).



While LCRs deliver immediate political gratification, they often come with high economic costs and uncertain effects. Box 2 summarizes the problems identified in the Peterson Institute report (Hufbauer et al. 2013).

Box 2. | Problems with LCRs

- The support conferred by LCRs on domestic producers is highly variable and government officials have little understanding of the effective rate of protection. For a given measure, protection could easily range from 20% to 100% *ad valorem* tariff equivalent.
- LCRs insulate domestic firms from foreign competition, causing lags in the adoption of new technology and defeating the goal of nourishing high-tech infant industries.
- Since LCRs work in an opaque manner, their adverse impact, in terms of price, quality and delays, on downstream producers is difficult to calculate. This helps to shield LCRs from both domestic reform and international surveillance.
- Infrastructure projects in particular suffer from extra delays and higher costs imposed by LCRs. These impacts are often unknown but highly variable, because they depend on supply and demand conditions in the local economy.
- LCRs are susceptible to corruption and favoritism, especially when the domestic industry has relatively few firms.
- LCRs are seldom bound by time limits or “sunset” provisions, a feature that leads to long-lasting market distortions.

WTO Rulebook. Existing rules in the WTO do restrict the scope of LCRs. But the rules have gaps that are exploited by creative officials. Equally important, the rules have not been vigorously enforced. It can be expensive to bring cases through dispute settlement procedures; additionally, countries may refrain from highlighting foreign abuses that are similar to policies they practice at home.

The WTO rulebook consists of provisions within the General Agreement on Tariffs and Trade (GATT Article III), the Government Procurement Agreement (GPA), the Agreement on Trade-Related Investment Measures (TRIMS), and the Agreement on Subsidies and Countervailing Measures (ASCM). In brief, WTO rules have proven most effective when LCRs violate the GATT obligation of national treatment in those cases where procurement commitments are covered by the GPA; they also violate investment rules when LCRs are attached to investment incentives in contravention of the TRIMS agreement. But in practice, existing rules have not stopped the proliferation of forced localization measures.⁵²

52 Only a few cases that challenge LCRs have been lodged in the WTO’s Dispute Settlement Body. The most recent cases include: (1) in November 2012, China requested consultations with the European Union regarding LCRs that affect renewable energy generation as a byproduct of feed-in tariff programs of EU member states; (2) in February 2013, the United States requested consultations with India concerning LCRs and subsidies in solar energy and, in February 2014, submitted a separate request for consultations following the implementation of phase II of India’s solar program; and (3) in May 2013, the WTO Appellate Body ruled with the European Union and Japan that LCRs attached to Canada’s feed-in tariff program for the wind sector violated WTO obligations under GATT and TRIMS.



A WTO code on LCRs is needed to strengthen existing obligations and add new disciplines where gaps exist in current agreements. While the code is being crafted, G-20 governments should commit not to impose new localization requirements and to roll back existing LCRs. A new WTO code to discipline LCRs would address the two leading problems that undermine existing disciplines: gaps in the multilateral rulebook and a lack of surveillance and enforcement.

Gaps in the GPA. The fact that government procurement is excluded from coverage under GATT Article III (*National Treatment*) means that, within the WTO system, only the GPA serves to limit LCRs attached to public procurement. The GPA covers a rather small share of federal and sub-federal procurement of goods and services, and only a limited number of WTO members are signatories. Any enlargement of GPA coverage will, as a matter of course, expand disciplines on the use of LCRs. The WTO estimates that the revised agreement, which entered into force in April 2014, could expand market access coverage to as much as US\$100 billion of procurement annually.⁵³ However, many GPA members will continue to take advantage of exceptions for specific projects and agency funds. US practice illustrates this problem. While the GPA schedule agreed by the United States covers over 80 federal entities that administer billions of dollars in government procurement, much of US public expenditure still remains outside GPA coverage. For example, under the “Buy America” clause, stimulus funds, when administered by the states, generally escaped from GPA coverage.⁵⁴ With these problems in mind, we suggest that a new LCR Code should begin to fill the gaps:

- **Proposed article in the LCR Code:** Any project administered by sub-federal governments (e.g., states, provinces, cities), which is significantly financed by the federal government, shall be subject to GPA obligations to the same extent as if the project was carried out by the federal government.
- **Proposed article in the LCR Code:** All members shall endeavor to use price preferences rather than content rules for all non-covered national procurement contracts, defined as those below the contract threshold and those procured by non-covered federal or sub-federal entities.
- **Proposed article in the LCR Code:** Transparency rules related to procurement processes and practices shall apply to both federal and sub-federal procurement of goods and services.

Gaps in TRIMs. The TRIMs agreement only applies to goods, *not* services, leaving ample room for discretionary LCRs. Among other gaps, new forms of LCRs related to technology transfer and data localization escape discipline under TRIMs.

- **Proposed article in the LCR Code:** The obligations of the TRIMs Agreement not to impose performance requirements as a condition of investment shall apply to services, including technology and data flows, to the same extent that they apply to goods.

53 “Historic deal reached on government procurement,” 2011 WTO News Items, 15 December 2011, www.wto.org/english/news_e/news11_e/gpro_15dec11_e.htm (accessed on 12 November 2013).

54 “Buy America” provisions were inserted into the 2009 American Recovery and Reinvestment Act (ARRA), the central fiscal program designed to combat the Great Recession. Such provisions have been included in subsequent US legislation, for example the Water Resources Reform and Development Act of 2014, which has been contested by GPA members, notably Canada. For more detail see, “Canada Raises Objections To New ‘Buy American’ Provisions At GPA Meeting,” *Inside US Trade*, 26 July 2014 www.insidetrade.com (accessed on 19 August 2014).



Gaps in the ASCM. The Canada wind turbine case (WTO 2013) illustrated the legal ambiguity in determining whether support schemes with LCRs qualify as prohibited measures under the ASCM.⁵⁵ The ASCM defines a subsidy to exist if there is a financial contribution, or price or income support by a government, that confers a benefit to the domestic industry. While ASCM Article 3 prohibits subsidies that are contingent on the use of domestic goods, a challenged LCR measure must first be proven to confer a benefit within the meaning of the agreement. In the Canadian case, the unresolved issue was determining whether the feed-in tariff program with LCRs conferred a benefit to domestic wind power generators, given pre-existing obligations imposed by Canadian energy regulation. Benefit analysis is clouded when, as in the wind turbine case, the burden is placed on the complainant to prove a benefit. The LCR Code should state that support schemes with LCRs attached are actionable, unless the respondent can prove the absence of a benefit. Moreover, going beyond ASCM Article 3, the LCR Code should cover services as well as goods.

- **Proposed article in the LCR Code:** Subsidies as defined in the ASCM, if coupled with LCRs on goods or services, shall be actionable when they result in adverse effects that cause serious prejudice to another Code member, unless the respondent can show that no benefit exists.

Disciplines in Plurilateral Agreements. Ideally the Trade in Services Agreement (TiSA) and the Environmental Goods Agreement (EGA) should contain their own LCR disciplines. Such disciplines would help set norms that the LCR Code could generalize through horizontal commitments across all sectors.

LCRs in energy services, audio-visual services, and digital services are growing, despite their effect of undermining the efficient operation of global value chains and deterring foreign direct investment. An LCR article in TiSA should constrain governments from imposing LCRs in service sectors, but allow for exceptions scheduled on a negative list. As detailed in the discussion of EGA-plus, LCRs are particularly prevalent in renewable energy projects, both at the federal and sub-federal levels of government. While support schemes and subsidies have been critical for renewable energies to compete with fossil fuels, linking them to LCRs almost always raises the cost of renewable energy deployment, besides contradicting the principle of national treatment (Hufbauer and Kim 2012). The EGA-plus pact should reinforce existing disciplines on LCRs and set relevant parameters for the use of LCRs in energy policies.

- **Proposed article in the LCR Code:** Except as scheduled in national annexes to the Code, members shall not apply LCRs to the public purchase of services within their territories. Scheduled exceptions shall be periodically reviewed by signatories to the LCR Code, with a view to their elimination.

Transparency and Surveillance. The crowning strength of the WTO has been its judicial body for dispute resolution. A close second has been its promotion of transparency and surveillance. The purpose of the “sunshine” function rings clear in the adage that “openness is a constraint on the abuse of discretion.” (Wolfe 2013, 4) The WTO surveys the trade policies of its members through three mechanisms: (1) notifications required of members on their national regulations, laws, and policies; (2) investigative country reviews conducted by the Trade Policy Review Mechanism (TPRM); and (3) crisis monitoring reports issued by the WTO Secretariat, which were initiated following the Great Recession (VanGrasstek 2013, 272).

55 For more detail on the “legal ambiguity” of the case, see Rubini (2013).



In this spirit, to facilitate more systematic assessment and surveillance, the LCR Code should create a new body to monitor national LCR practices. This could be modeled after the Global Trade Alert (GTA), which is coordinated by the Centre for Economic Policy Research (CEPR) and supported by the World Bank, among others.

- **Proposed article in the LCR Code:** Members shall issue timely reports, updated semi-annually, of all new and existing LCRs imposed by all federal and sub-federal government agencies within their jurisdiction. Members shall establish the LCR Monitoring Body, mandated to issue annual reports identifying the LCRs of member countries, and analyzing both their economic impact and their consistency with the LCR Code.

To avert the “glass house” syndrome, which often hobbles effective WTO action, the LCR Code should specify notification procedures including requirements for a quantitative assessment of the cost of each LCR, its margin of preference, and the policy’s duration. Further, the Code should specify penalties for non-compliance.

- **Proposed article in the LCR Code:** Members shall comply with WTO notification requirements for new LCRs, with recourse to reverse notification procedures, whereby each Code member can request that another member notify unreported measures.
- **Proposed article in the LCR Code:** Inadequate compliance with notification procedures, so determined by the Code Committee, shall forfeit the member’s right to file complaints against other Code members for a period of time set by the Committee.

Ideally, the obligations of the LCR Code should be subject to enforcement by the Dispute Settlement Body of the WTO. But if the LCR Code is initially not brought under the WTO umbrella, the Code should include dispute procedures that parallel those in the WTO. In any event, pursuing a case in the WTO requires political energy and financial means, the timeline for resolution is lengthy, and the remedies are often inadequate. To mitigate these obstacles, an LCR Code might include WTO-plus procedures for dispute resolution.

Proposed article in the LCR code: A complaining Code member shall be permitted to request the establishment of an arbitration panel after consultations not to exceed 30 days. If the complaining party prevails, the arbitration panel shall assess monetary damages against the responding party to compensate for the impermissible LCR. The monetary damages so awarded shall be paid to the injured private parties.

Investment Framework Agreement⁵⁶

An Investment Framework Agreement could improve the business climate in signatory countries. Moreover, our simple analysis, summarized in Box 3, suggests that a country can boost its inward FDI stock by improving its business climate. According to our rough estimates, an improvement of 20 points in the business climate could raise the stock of inward FDI expressed as a percentage of GDP by 15%. Box 2 describes our analysis in greater detail. In this section we lay out the current state of affairs for global FDI agreements and offer suggestions for moving forward.

⁵⁶ This section is distilled from WEF (2012).



Box 3. | FDI and Business Climate

This analysis excludes FDI in the primary sector (principally petroleum and mining). The regression covers 24 countries, primarily OECD members, although a few others are also included (Russia, Argentina, Malaysia, Brazil and China). Data on GDP are drawn from the World Bank, while FDI data are taken from the OECD and the ITC's Investment Map.

The World Bank's Doing Business Report assigns each country a "distance from frontier" score in each of 12 categories. A score of 100% would indicate that a country had achieved the best practice on record in each component of that category, while a score of 0 would indicate extremely poor performance. Taking the average of 12 scores paints a rough picture of a country's overall business climate, which is used in the regression below. The regression also includes the log of GDP, to capture the fact that larger economies satisfy a greater proportion of their investment needs domestically. As expected, a larger economy has less FDI relative to GDP (shown by a negative coefficient on log (GDP)), while a friendlier business climate attracts more FDI.

Inward FDI stock (non-primary), percent of GDP	Coefficient	Robust Std. Error	t-statistic
log (GDP)	-0.379	0.018	-2.13
DB Frontier	0.770	0.168	4.58

Using these results as a guide, we provide a rough estimate for the potential impact of a global investment agreement. If a fully implemented IFA removes half of the "gap" between current policy and best practice as measured by the Doing Business report, then the above coefficient would predict that inward FDI would increase by almost 40% of the country's initial distance from the frontier. For the countries included in this analysis, that net impact is a roughly 10% increase in total inward FDI, or US\$1.2 trillion at 2012 levels. Table 10 presents estimates for each country.

Table 10 | Inward Foreign Direct Invest Stock, (latest available year)

	Inward FDI Stock (\$ billions)	GDP (\$ billions)	FDI/GDP	DB Closeness to Frontier	Estimated FDI gains, ambitious IFA (\$ billions)
Argentina	66	558	12%	56%	11
Australia	356	1575	23%	81%	26
Austria	164	394	42%	78%	14
Brazil	549	2143	26%	53%	99
Canada	515	1821	28%	80%	39
Chile	111	268	41%	71%	13
China	2160	8221	26%	59%	339
Denmark	144	315	46%	85%	8
Finland	94	247	38%	82%	7



France	1026	2611	39%	72%	111
Germany	915	3628	25%	80%	71
Israel	73	258	28%	73%	8
Italy	358	2013	18%	67%	45
Japan	206	5938	3%	79%	17
Korea	156	1130	14%	84%	10
Malaysia	120	248	49%	82%	8
Mexico	331	1182	28%	71%	37
Netherlands	608	770	79%	77%	55
Norway	142	500	28%	83%	9
Poland	233	490	48%	72%	25
Russia	94	1525	6%	62%	14
Turkey	181	789	23%	67%	23
United Kingdom	1357	2462	55%	84%	86
United States	2509	16245	15%	84%	155

Excludes primary sector FDI

DB refers to the Doing Business Report

Sources: WDI, Eurostat, OECD, ITC

Multilateral Investment Agreements. Unlike international trade, no multilateral agreement or institution oversees FDI, but three attempts were made in the decades after the Second World War. In the first attempt, investment disciplines were negotiated in the draft Havana Charter of 1948, but the entire Charter was rejected by the US Congress. What survived from the Havana Charter, without any investment provisions, was the General Agreement on Tariffs and Trade (GATT).⁵⁷

A second attempt was made through OECD efforts between 1995 and 1998 to craft a Multilateral Agreement on Investment (MAI). The draft agreement was widely, if ignorantly, condemned by NGOs, and generally opposed by developing countries that were not involved in the negotiations and did not want to undertake new obligations that would constrain requirements that they could apply to multinational corporations. France then withdrew its support, and the OECD talks were suspended in December 1998 (See Graham 2010).

A third attempt took place within the WTO itself, when investment and three other “Singapore issues” (competition policy, government procurement and trade facilitation) were included within the original Doha negotiating mandate.⁵⁸ Disagreement between WTO members at the Cancun Ministerial in 2003 sank three of the “Singapore issues”, including investment (trade facilitation survived).

⁵⁷ Some 53 countries signed the Havana Charter to create the International Trade Organization; however, the original GATT was signed by just 23 countries, as many developing countries did not accept the absence of investment provisions designed to curb international business firms.

⁵⁸ At the 1996 Singapore Ministerial Conference, WTO Ministers set up working groups on trade and investment, on competition policy, and on government procurement. Ministers also instructed the WTO Goods Council to look at “trade facilitation”. These became the “Singapore Issues” included in the Doha Development Agenda.



While the multilateral record on investment is dismal, it should be recalled that the Uruguay Round (1986-1994) delivered two agreements which cover limited aspects. The first is TRIMS (Trade-Related Investment Measures), which disciplines local content and other performance requirements linked to inward FDI; the second is GATS (General Agreement on Trade in Services) which defines FDI as one of the four ways of delivering services to a foreign market (mode 3 or “commercial presence”).

Plurilateral Investment Agreements. Plurilateral investment agreements are not new, but those concluded are limited in scope. Both the OECD and APEC have developed codes to be followed by their member economies.

The OECD *Code of Liberalisation of Capital Movements* (1961) and the *Code of Liberalisation of Current Invisible Operations* (1972) require non-discriminatory liberalization of capital movements, the right of establishment, and free current account transactions among OECD countries. An unconditional MFN rule applies between Code members. In 2011 and 2012 the OECD Council opened the Codes to non OECD members willing and able to meet the standards.⁵⁹

The OECD also developed the 1976 Declaration and Decisions on International Investment and Multinational Enterprises (DIIME), a policy commitment to improve the investment climate. So far nine non-OECD countries have subscribed to the Declaration (Argentina, Brazil, Colombia, Egypt, Latvia, Lithuania, Morocco, Peru and Romania), which consists of four rather general elements:⁶⁰

- The Guidelines for Multinational Enterprises: voluntary rules of conduct for multinational enterprises.
- National Treatment: Signatories shall accord to foreign-controlled enterprises no less favorable treatment than accorded in like situations to domestic enterprises.
- Conflicting requirements: Signatories shall co-operate so as to avoid the imposition of conflicting requirements on multinational enterprises.
- International investment incentives and disincentives: Signatories will endeavor to make measures as transparent as possible.

APEC members developed their own set of “Non-binding Investment Principles” in November 1994 with guidelines for 12 different areas of investment, including national treatment, investment protections and dispute settlement. The principles were very general, and were further refined and augmented by APEC countries in 2011 notably with regard to the consistency of interpretation and implementation of investment policies, the use of investment incentives, and protection and enforcement of investor rights.⁶¹

Bilateral Investment Treaties (BITs). While multilateral investment agreements are non-existent and plurilateral agreements are thin, over 2900 BITs are in force (see UNCTAD 2014, 114). Nearly every country in the world has signed several BITs – even Cuba has signed 61. But despite a common

59 See www.oecd.org/investment/investmentpolicy/39664826.pdf; and www.oecd.org/daf/financialmarketsinsuranceandpensions/privatepensions/invisible%20operations_web%20english.pdf.

60 See “Guidelines for multinational enterprises,” OECD, www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/investmentinstruments.htm.

61 APEC members also worked on model measures for commonly accepted RTA chapters from 2005 to 2008 in order to serve as guidelines, but investment was not one of the areas included, given the lack of agreement.



name, BITs differ significantly in their content. For example, the United States and the European Union have developed model BITs with differing approaches.⁶² Both models cover major areas in a similar manner (market access, financial transfers, key personnel, expropriation, and dispute settlement), but they differ with respect to certain aspects. Both “pre” and “post” establishment are covered in the US model BIT, while “post” establishment investment is the focus of the EU model (see Houde and Yannaca-Small 2004). The US model contains more disciplines on performance requirements and investor protection, and covers state-owned enterprises and environmental and labor policies linked to FDI. As might be expected, Chinese BITs cover considerably less ground than either the US or EU models.⁶³

Regional Investment Agreements. In 1994, NAFTA broke new ground on investment rules in a free trade agreement. NAFTA chapters cover both investment protection (typically treated in bilateral investment treaties) and market access (both pre-establishment and post-establishment rights). The agreement provides both investor-state and state-to-state dispute settlement provisions. The NAFTA approach is now standard fare in US free trade agreements and, as amended and updated, seems likely to feature in two mega-regional agreements, the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP). However, for complex and sometimes misguided reasons, considerable opposition has been expressed in Europe to investor-state dispute settlement (ISDS) provisions.

Other countries have somewhat different approaches in their Regional Trade Agreements (RTAs). The main differences concern the extent of market access for foreign investors, and the extent of protection once investment takes place. On a bilateral basis, developing governments have actively sought partners for BITs as a way to promote trade and investment. As of 2013, Brazil had 14 BITs in force, China had 130, and India had 84 (UNCTAD 2014, Annex table 7). Neither Brazil nor India has entered into an RTA with deeper disciplines on investment and, compared to US or EU BITs, the content of their BITs is shallow. It is not clear that these agreements, or others like them, will attract FDI. However, recent Chinese investment agreements with Japan and Korea, and the China-Canada BIT, have somewhat stronger provisions, and could set precedents for other developing countries seeking to expand their investment agreements.

The Case for a WTO Investment Framework Agreement (IFA).⁶⁴ In light of the fragmented record of investment agreements in other settings, the WTO’s future agenda would not be complete without its own investment agreement.

It must be emphasized that the context today is completely different from the late 1990s, when the OECD’s MAI crashed and burned. Emerging economies, led by China, Brazil, and India, are now major investors. In fact, developing countries surpassed developed countries as purveyors of outward FDI in 2012. Ironically, a significant number of developing countries now seek to join RTAs with substantive investment obligations similar to those that were kicked off the Doha Round agenda in 2003. Consequently the North-South divide on investment issues has substantially narrowed – except in the WTO. WTO diplomats should recognize these changes and reconstitute work in the WTO on an Investment Framework Agreement (IFA).

62 The Lisbon Treaty of 2009 gave the EU competence to negotiate BITs on behalf of member states. Existing BITs remain in force but will be gradually replaced by EU BITs.

63 See Berger (2008), in particular pp. 3-8 and Fang (2015), pp. 1-11.

64 This section draws heavily on Gary Hufbauer and Sherry Stephenson, “The case for a framework agreement on investment,” *Columbia FDI Perspectives*, No. 116, 3 March 2014, http://ccsi.columbia.edu/files/2013/10/No_116_-_Hufbauer_and_Stephenson_-_FINAL.pdf.



The IFA should start life as a plurilateral agreement. While the WTO has 161 member countries and customs territories (such as Hong Kong), only willing nations would be signatories of the agreement. Initially, only IFA members would be entitled to IFA rights – in other words, the unconditional MFN principle would not apply to WTO members that are not signatories. Over time, the great majority of WTO members might join the IFA and, at some point, all IFA rights might be extended on an unconditional basis to all WTO members, including the holdouts.

The IFA would not supersede bilateral investment treaties (BITs) or investment chapters in bilateral and regional free trade agreements – they would coexist. In disputes, complainants could seek remedies under whichever agreement was most favorable. Quite often, as between pairs of countries, their BIT or FTA rights would be more extensive than their IFA rights. But complainants should not be allowed to “shop” among forums, for example by bringing a case first under the IFA and then under an FTA.

Like BITs and most FTAs, the IFA should provide for state-to-state dispute settlement. In addition, signatories to the IFA should consider investor-state arbitration (ISDS). All arbitration and dispute-settlement decisions should be published, adding to the body of customary international law in the FDI realm.

What would be the advantages of the IFA? First is the matter of negotiating economy. Between 161 WTO members, the maximum possible number of BITs is 25,760 (161x160). While there are some 2,900 existing BITs, they represent only a ninth of the theoretical maximum. It would make sense for many small states to rely on the IFA rather than spend time negotiating and ratifying new BITs between themselves.

The second advantage follows from a central fact of modern commercial life: FDI is driving global value chains (GVCs), both in goods and services. Despite their name, the GVCs have been mostly regional to date and are centered in Asia, North America and Europe, leaving many parts of the world in the cold. In other words, many countries are excluded from these networks, which effectively serves as a black mark when they compete for foreign investment. By establishing minimum standards for “outsider” countries, the IFA would make them more attractive and enable them to link up with GVCs.

Third, the stark reality is that a great many WTO members are not – and will not – become members of the Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership, the Regional Comprehensive Economic Partnership, or the Pacific Alliance. The IFA will give MNCs confidence to invest in these “outsiders” by providing the needed guarantees and long-term certainty for potential investors.

Finally, an IFA will make the WTO more relevant to business. Just as the TISA negotiations have brought life into the dormant but critical area of services, so the IFA would burnish the WTO’s credentials by setting minimum standards for investment.

With these advantages in mind, we believe that the IFA should include the following substantive provisions:

- Covered investments should be afforded both national treatment and MFN treatment in all phases of the investment cycle: pre-establishment and post-establishment, management, operation, expansion, and disposition.



- Justifiable reasons for expropriation should be limited, and “prompt, adequate and effective compensation” should be paid when expropriation occurs.
- Investment-related funds should be transferable across borders, without delay and using a market rate of exchange.
- Performance requirements should be prohibited or restricted. However, the least developed countries might be allowed a reasonable period of time (such as a decade) to phase out their performance requirements.
- Foreign firms should be guaranteed the right to employ top managerial personnel, regardless of their nationality.
- Advance publication of proposed laws and regulations affecting investment should be required, giving firms an opportunity to comment.

Business firms around the world need multilateral disciplines and market access guarantees. In the FDI realm, these have not yet been provided by the WTO. The world today is a very different place compared to the late 1990s, when the MAI collapsed. GVCs are the most economical way to serve customers worldwide, and investment driving these chains should be at the center of the WTO agenda. The current patchwork of investment disciplines in BITs, FTAs, and the OECD leaves many countries out; an investment framework agreement with modern disciplines is both necessary and overdue.

Exchange Rate Practices

A lively debate surrounds the WTO’s role, and the role of mega-regional agreements such as TPP, in addressing the exchange rate practices of their members. Protagonists point to the undeniable fact that exchange rate movements in the course of a week can offset tariff reductions negotiated over a decade. To buttress their argument, protagonists contend that large current account imbalances erode the appetite for fresh liberalization, at least among deficit countries.

Antagonists counter by observing that the International Monetary Fund (IMF) has primary responsibility for exchange rate practices. The text of the GATT (in particular Article XV, *Exchange Arrangements*) assigns the WTO at most a secondary role. With great force, antagonists emphasize the political reality that finance ministers and central bankers adamantly oppose any attempt by trade officials to encroach on their area of responsibility. In 2012, when Brazil, after much effort, persuaded the WTO to hold a meeting on exchange rates, Chinese and US officials joined forces in opposition and insisted that the meeting be closed to the public.

Litigation Option. Among the protagonists, at least three camps can be distinguished. The first camp argues for all-out WTO litigation under existing rules. In 2004, the National Association of Manufacturers (NAM) and other members of the Fair Currency Alliance (FCA) urged the US Trade Representative to bring a massive WTO case against China (see Hufbauer, Wong, and Sheth 2006). The FCA draft petition cited breaches of the Agreement on Subsidies and Countervailing Measures, as well as GATT Article XV (*Exchange Arrangements*) and GATT Article XXIII (*Nullification or Impairment*). The WTO litigation approach was rejected by the George W. Bush administration. The FCA, renamed as the China Currency Coalition (CCC), then took its appeal to the US Congress, but the draft bill (HR 1498, introduced in 2005) was never enacted. When President Barack Obama was elected, the CCC urged the new administration to champion anti-dumping (AD) and countervailing



(CVD) remedies against undervalued exchange rates. While separate bills to this effect were passed in the House and Senate,⁶⁵ no law was enacted, and the CCC faded from sight.

TPP Option. A second camp, currently debated in the US Congress, has insisted that an exchange rate chapter be included in the Trans-Pacific Partnership agreement. Bergsten (2014) authored an influential Policy Brief urging this course of action and some 60 Senators and 230 Congressmen signed letters to President Obama urging this approach. The objective is to commit TPP members to abstain from “manipulation”, broadly defined as sustained intervention in currency markets by a trade surplus country to depress the exchange rate and further improve the trade balance. The recommended TPP chapter would track the relevant IMF article but add specific thresholds,⁶⁶ and impose trade sanctions for misbehavior. To date, the Obama administration has rejected such an approach but has been willing to augment criteria that Treasury follows in its reporting and consultations on currency manipulation.

CVD Option. A third camp contends that national countervailing duty measures, preferably coordinated by like-minded countries, would prove most effective for redressing “manipulation”. As mentioned, this approach was championed by the CCC at the beginning of the Obama administration. A leading academic advocate is Aluisio de Lima-Campos (2014).⁶⁷ The US Congress has picked up the idea and is drafting a companion bill to Trade Promotion Authority that would authorize countervailing duties equal to the subsidy equivalent of manipulated and undervalued currencies. Under his approach, the US imposition of CVDs would put the onus on the offending country. That country could challenge their consistency with the Agreement on Subsidies and Countervailing Measures (ASCM) by bringing a WTO case. We strongly believe that such practices would be found to violate WTO obligations, but a case would take at least two years before the Appellate Body handed down a decision. Meanwhile countervailing duties would be collected, possibly on a wide range of imports. Even if the target country ultimately prevailed in the WTO, duties previously collected would not be retroactively refunded.⁶⁸ This daunting prospect, coupled with the uncertainty of litigation, might persuade the manipulator to desist from intervening in the foreign exchange market.

Revived Interest. Prior to the TPP debate in the United States, the idea of using trade remedies to combat currency manipulation did not attract significant support in the US Congress or the White House. A massive WTO case was rejected by President Bush and quietly disappeared during the Obama administration. US Trade Ambassador Michael Froman refused to pursue the issue as part of TPP negotiations⁶⁹ and no TPP member country has endorsed the idea. No country has so far amended its domestic CVD laws to characterize currency “manipulation” as a countervailable subsidy, but the United States is seriously considering doing so.

65 In 2010, the House passed HR 2378, the Currency Reform for Fair Trade Act, but it failed in the Senate. In 2011, the Senate passed S 1619, 112th, the Currency Exchange Rate Oversight Reform Act, but it failed in the House.

66 IMF Article IV, Section (iii) commits members to “avoid manipulating the exchange rate or the international monetary system in order to prevent effective balance of payments adjustment or to gain unfair competitive advantage over other members.” Under Bergsten’s proposal, threshold levels of three variables would need to be specified to trigger a finding that the commitment had been violated: large current account surpluses, excessive levels of reserves, and substantial intervention. In an earlier Policy Brief, Bergsten and Gagnon (2012) spelled out these triggers in detail.

67 Aluisio de Lima-Campos, “Currency Misalignments and Trade: A Path to a Solution”, World Trade Institute, University of Bern, 10-12 July 2014.

68 Gary Clyde Hufbauer and Cathleen Cimino, “Looming US-China Trade Battles?: Currency Manipulation (Part I),” Trade and Investment Policy Watch, 6 March 2015. <http://blogs.piie.com/trade/?p=142> (accessed March 23, 2015).

69 “Froman To Testify Before Trade Committees Next Week On Trade Agenda,” *Inside US Trade*, March 28 2014, www.insidetrade.com.



In an earlier report, we suggested that a plurilateral WTO Code might be designed that would spotlight exchange rate practices that damage the trading system (Hufbauer and Schott 2012). The Code would work through interaction between the IMF and the WTO. Even this tempered suggestion had no traction. One reason was that both Chinese trade surpluses and US trade deficits declined as a share of respective GDP levels after 2007 (table 11). More generally, the trade imbalances of the top five surplus and deficit countries are also smaller in 2014 than they were seven years ago (table 12). Moreover, the range of undervaluation and overvaluation among the top five surplus and deficit countries has narrowed sharply since 2008 (table 13). Finally, to ease global concerns and for its own internal economic health, China has given market forces greater sway over the renminbi exchange rate.⁷⁰

Table 11 | Chinese and US Current Account Balances, 2004 – 2013 (% of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
China	3,57	5,87	8,55	10,11	9,30	4,87	4,01	1,86	2,35	2,60
United States	-5,12	-5,65	-5,76	-4,93	-4,63	-2,65	-3,00	-2,95	-2,71	-2,30

Sources: OECD, State Administration of Foreign Exchange of the People's Republic of China

Table 12 | Top 5 Current Account Surplus and Deficit Countries, 2004 – 2013 (% of GDP)

Top 5 Surplus Countries

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Germany	4,6%	5,0%	6,2%	7,5%	6,2%	5,9%	6,2%	6,8%	7,5%	7,6%
Japan	3,7%	3,7%	3,9%	4,8%	3,3%	2,9%	3,7%	2,0%	1,1%	0,7%
China	3,6%	5,9%	8,5%	10,1%	9,3%	4,9%	4,0%	1,9%	2,3%	2,6%
Russian Federation	10,1%	11,1%	9,7%	6,0%	6,2%	3,8%	4,7%	5,2%	3,6%	1,6%
Netherlands	7,7%	7,5%	9,4%	6,7%	4,3%	5,2%	7,4%	9,1%	9,5%	10,9%
Weighted Average	6,9%	7,7%	8,8%	8,2%	6,8%	5,3%	6,1%	5,8%	5,6%	5,4%

Top 5 Deficit Countries

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
United States	-5,1%	-5,6%	-5,8%	-4,9%	-4,6%	-2,6%	-3,0%	-2,9%	-2,7%	-2,3%
Spain	-5,3%	-7,4%	-9,0%	-10,0%	-9,6%	-4,8%	-4,5%	-3,7%	-1,2%	0,8%
United Kingdom	-2,0%	-1,8%	-2,8%	-2,2%	-1,0%	-1,4%	-2,7%	-1,5%	-3,8%	-4,5%
Brazil	1,7%	1,6%	1,2%	0,2%	-1,7%	-1,4%	-2,2%	-2,1%	-2,4%	-3,6%
Turkey	-3,6%	-4,4%	-6,0%	-5,8%	-5,4%	-1,9%	-6,1%	-9,6%	-6,2%	-7,9%
Weighted Average	-4,2%	-4,7%	-5,1%	-4,6%	-4,3%	-2,5%	-3,1%	-3,0%	-2,8%	-2,6%

Sources: OECD, State Administration of Foreign Exchange of the People's Republic of China.

Notes: Weighted average of the current account balances as percent of GDP. The weights are based on the percent of GDP (2008) accounted for by top surplus and deficit countries.

⁷⁰ The IMF has also become more active in monitoring exchange rates, largely in answer to criticism from US sources. See "Yuan's Real Exchange Rate Undervalued 5%-10%, IMF Report Says," *Bloomberg News*, 1 August 2013, www.bloomberg.com/news/2013-08-01/china-s-real-exchange-rate-undervalued-5-10-imf-report-says.html.



Table 13 | Fundamental Equilibrium Exchange Rates (FEERs) for Selected Countries, 2008-2014

Needed changes in multilateral exchange rates (percent)

Positive number indicates currency is undervalued and needs to appreciate; negative number indicates currency is overvalued and needs to depreciate to achieve equilibrium

Top Surplus Countries							
	2008	2009	2010	2011	2012	2013	2014
Germany (Euro)	-7,2	-0,9	-2,5	-2,3	-1,1	-0,8	-1,3
Japan	5,7	-1,2	-2,0	-1,8	-0,8	9,4	-0,9
China	18,4	21,4	13,5	16,0	2,8	2,2	1,1
Russian Federation	-0,6	0,2	-1,3	-1,2	-0,5	-0,5	-0,6
Netherlands (Euro)	-7,2	-0,9	-2,5	-2,3	-1,1	-0,8	-1,3
Weighted Average	11,2	19,9	9,6	12,4	1,2	4,1	-0,9
Top 5 Deficit Countries							
	2008	2009	2010	2011	2012	2013	2014
United States	-8,6	-17,4	-7,8	-8,5	-4,3	-3,1	-1,1
Spain (Euro)	-7,2	-0,9	-2,5	-2,3	-1,1	-0,8	-1,3
United Kingdom	-6,6	-0,6	-1,4	-1,3	-0,6	-0,8	-0,7
Brazil	-1,4	-0,7	-5,9	-10,1	-1,1	-4,3	-9,0
Turkey	-13,0	-0,5	-11,7	-29,1	-25,6	-29,9	-12,9
Weighted Average	-7,9	-12,2	-6,6	-8,0	-4,1	-3,6	-2,0

Sources: Estimates of Fundamental Equilibrium Exchange Rates 2008 - 2014, William Cline, John Williamson

This scene could soon change. The soaring value of the dollar in foreign exchange terms, owing to the much better performance of the US economy than other advanced countries, will almost certainly widen the US trade deficit. That alone has revived currency manipulation in US political debate. If the US Congress passes currency legislation in a companion bill to Trade Promotion Authority, the issue will be in play, both as a subject of litigation and as a topic of negotiation. Accordingly we suggest that the annual WTO Public Forum – held in the early fall – sponsor invited guests to discuss “exchange rate and trade” issues in 2015 as a means of asserting the WTO’s institutional interest. Depending on the outcome of US currency legislation, the time may be ripe to convene a plurilateral discussion within the WTO.

State-Owned Enterprises⁷¹

Private firms are troubled by the huge role of state-owned, state-supported and state-controlled enterprises (collectively referred to as SOEs). The complaint is often heard that SOEs enjoy the advantages of opaque subsidies and protected home markets, allowing them not only to keep privately-owned enterprises (POEs) off their home turf, but also to grab market share abroad.

A new plurilateral code on the conduct of SOEs would not be written on a blank slate. The WTO inherited an SOE rulebook of sorts from the GATT, and these rules were augmented by China’s

71 This section is a condensed version of Chapter 12 in Bergsten, Hufbauer and Miner (2014).



Protocol of Accession to the WTO agreed in 2001. Moreover, the United States has added to the WTO Protocol rulebook in its bilateral free trade agreements, notably the US-Singapore FTA. The discussion that follows walks through the existing rules.

WTO Rulebook. In the GATT, market systems are the norm; state-run systems are the exception. In 1994, the WTO re-enacted the GATT-1947 and adopted several new agreements, including the General Agreement on Trade in Services (GATS), the Agreement on Subsidies and Countervailing Measures (ASCM), and the agreement on Trade Related Investment Measures (TRIMS). Selected provisions in all these texts affect the conduct of SOEs.

GATT Article XVII (State Trading Enterprises). After the Second World War it was feared that some government-sanctioned monopolies might play fast and loose by manipulating markets. In subsequent decades, some state-trading enterprises (STEs) indeed distorted world trade in important and not-so-important commodities – oil (the OPEC cartel) as well as rice, cocoa, coffee, tin and a few others. However, Article XVII has rarely been invoked.

One reason is that the sub-text of Article XVII appears to deprive the article of an effective bite against abusive trading practices. Article XVII(1)(a) calls on governments to ensure that an STE “...shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment...”

But Article XVII(1)(b) goes on to announce that STEs shall:

...make any such purchases or sales solely in accordance with commercial considerations,* including price, quality, availability, marketability, transportation and other conditions of purchase or sale,...

Note

*The charging by a state enterprise of different prices for its sales of a product in different markets is not precluded by the provisions of this Article, provided that such different prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.

In the only case centering on Article XVII, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain* (DS276), decided by the Appellate Body in 2004, the US allegations were rejected by the panel for lack of sufficient evidence. The footnote cited above, explaining the meaning of “commercial considerations,” allows ample latitude for STEs to price discriminate as they wish.

General Agreement on Trade in Services. When it comes to services, the core architecture of the GATS allows for obligations to be imposed on SOEs. Obligations under the GATS are subscribed by members on a “positive list” basis – the service in question must be positively scheduled before foreign firms are guaranteed the right to compete in domestic markets. China, for example, has not scheduled several sectors dominated by SOEs.

However, GATS Article VIII may provide an avenue to attack abusive practices of SOEs in service industries (e.g., banking, telecommunications) even when they are not scheduled under the positive list. Article VIII(1) requires “monopoly suppliers” to observe the MFN principle in their dealings with other WTO members, and Article VIII(2) prohibits the “abuse of [a supplier’s] monopoly position” when it competes outside the scope of its monopoly rights – but only if the member country



has made a specific commitment to fair dealing. Moreover Article VIII(5) applies the foregoing provisions to “exclusive service suppliers”, the situation that exists when a small number of non-competitive suppliers do business in a member’s territory. So, when a country commits to fair dealing, SOE abuses in the service industries could be attacked under Article VIII(5).

Agreement on Subsidies and Countervailing Measures. An unsettled question is whether SOEs are “public bodies”, for purposes of the ASCM, when they confer a subsidy on *another* firm (POE or SOE). At one time, the US Department of Commerce took the view that all Chinese SOEs are public bodies, but this view was rejected by the WTO Appellate Body in 2011.⁷² Instead, the WTO Appellate Body adopted a case-by-case approach, to determine whether the SOE in question is carrying out a government mission (Ding 2014). State ownership is one factor, but not the decisive factor, in deciding whether subsidies given by an SOE to another firm are the actions of a “public body” that can be attributed to the WTO member.⁷³

Bilateral and Regional FTAs. Competition chapters, including disciplines on SOEs, are now standard fare in US free trade agreements. The United States first addressed the SOE question in NAFTA, signed in 1993. In Chapter 15, titled *Competition Policy, Monopolies and State Enterprises*, Articles 1502 and 1503 announced limited disciplines in situations where the state authorizes a monopoly or operates a commercial enterprise (see OECD 2008). Designated monopolies are supposed to act in accordance with commercial considerations except when their mandate says otherwise (e.g., provide cheap gasoline to the public). SOEs are admonished not to abuse NAFTA obligations when they use delegated governmental powers, such as the power to grant licenses, approve commercial transactions, or impose quotas or fees.

Language similar to NAFTA was a staple of US FTAs with Australia, Chile, Korea and Peru. But more detailed and stronger terms were contained in the US-Singapore FTA, signed in 2003, and in its day the most advanced agreement on SOEs (reflecting their importance in the Singapore economy). That agreement calls for enhanced transparency, requires SOEs to act in accordance with commercial considerations, not abuse their monopoly or regulatory powers, and prohibits direct government influence on SOEs.

Investment Guidelines. In recent decades, most countries have laid out the welcome mat for inward foreign direct investment (FDI), sometimes providing generous financial incentives as well. Even so, many countries are wary when the foreign firm is an SOE, or when a domestic firm competes in its home territory with a foreign SOE.

In 2013, Canada issued a new set of investment guidelines, interpreting the Investment Canada Act. In the guidelines, Canada adopted a “net benefit” test with respect to SOE acquisitions, with the burden of proof assigned to the acquiring firm. The United States does not go so far, but legislation requires the Committee on Foreign Investment in the United States to screen all SOE takeovers of US firms for possible threats to US national security.

WTO Code on SOEs. If plurilateral negotiations are launched, the definition of covered SOEs will be a threshold issue. Which state-supported and state-controlled firms will be covered? Will sub-federal SOEs be covered? What about sovereign wealth funds?

⁷² See *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R11, adopted 11 March 2011, World Trade Organization.

⁷³ Other factors might include, for example, the active participation of senior public officials in key meetings of the SOE.



Once the issue of coverage is settled, substantive questions need to be addressed. Here is our own sampler.

- For starters, the SOE Code should elaborate on GATT Article XVII to better define acting “in accordance with commercial considerations”. Language along the following lines might be useful: “‘in accordance with commercial considerations’ shall mean free from government influence and consistent with normal business practices of privately-held enterprises in the relevant business or industry”.
- Language similar to the Singapore-US FTA Article 12.3(1)(c)(iv) precluding the abusive use of a monopoly position is needed. So is a section on national treatment, to ensure that SOEs treat imports the same as domestically-produced goods, services and IPR.
- SOEs should be subject to the jurisdiction of other Code members when they engage in commercial activities abroad (in other words, no claims of “foreign sovereign immunity” by SOEs).
- Covered SOEs should not be allowed to combine different lines of business to a greater extent than would any privately owned enterprise (POE) with which it competes in its home market.
- SOEs should publish their financial accounts in a timely manner, according to International Financial Reporting Standards. They should disclose loan terms from state-owned banks and all transactions with other state-owned companies. They should disclose tax payments and preferences, and any incentives or subsidies received from central, state or provincial governments.
- SOEs should disclose leading officers and all directors, and their past and present connections to government office, as well as policy directives or suggestions received from government officials.
- For purposes of the ASCM, covered SOEs should be regarded as “public bodies” when they confer subsidies on POEs or SOEs operating within the national territory.

Export Controls

During the past five years, national export controls on oil and minerals suddenly came to the attention of the world trading system, reflecting three developments. First, in 2009, the United States, the European Union, Japan and other countries launched a WTO case against Chinese export duties and quantitative restrictions on a broad array of industrial minerals (bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus and zinc). Second, in 2012, the United States and many of the same countries launched another WTO case against Chinese export duties and quantitative restrictions on rare earths widely used in electronic products, along with tungsten, and molybdenum. In both cases, the WTO Appellate Body ruled against China (on *Raw Materials* in 2012, and on *Rare Earths* in 2014).⁷⁴ The third and most important development is the shale revolution, converting the United States into a potential exporter of

⁷⁴ The two WTO cases are: *China – Measures Related to the Exportation of Various Raw Materials* (DS394), Appellate Body report circulated 30 January 2012; and *China – Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum* (DS431), Appellate Body report circulated 7 August 2014.



liquefied natural gas (LNG) and crude oil.⁷⁵ US legislation dating from an earlier era restricts but does not forbid US exports of LNG and crude oil. These restrictions raise serious concerns with US trading partners in Europe and Asia, but so far no country has challenged the United States.

WTO Rulebook. The WTO rulebook on export duties and quantitative restrictions is relatively short. Export duties are prohibited only when scheduled in a member's WTO bindings. The US Constitution (Article 1, section 9) forbids export duties, but not export controls. China, in its Protocol of Accession, committed not to impose export duties – a central reason why the Appellate Body ruled against China in the cases on *Raw Materials* and *Rare Earths*. Few other countries face across the board constraints in their domestic legislation or international agreements, which means that they enjoy considerable latitude to impose export duties and other controls.

Unlike export duties, quantitative limitations are generally subject to GATT discipline. GATT Article XI (*General Elimination of Quantitative Restrictions*) forbids both import and export quotas (and kindred measures such as licensing requirements). Article XI(2)(a) provides an exception for “restrictions temporarily applied to relieve critical shortages of foodstuffs or other products...” Since the *Raw Materials* restrictions were not “temporarily applied” this defense fell flat and China did not even raise a similar defense in *Rare Earths*. US limitations on LNG and crude oil exports have been on the statute books for more than 40 years, clearly violating Article XI.⁷⁶ But that piece of trade history illustrates the true problem with Article XI: in very few instances have GATT or WTO cases been brought against quantitative export restrictions.⁷⁷

Quantitative export restrictions can act as subsidies both to domestic and export production of downstream goods, by depressing the local price of natural resources. Such restrictions could violate the Agreement on Subsidies and Countervailing Measures (ASCM). This possibility was raised but not litigated in *Raw Materials* and *Rare Earths*. It was litigated, however, in an earlier case, *US-Softwood Lumber III* (DS236), launched by Canada against the United States in 2001. The panel found that Canada's prohibition on log exports could in principle subsidize Canadian softwood lumber exports to the US market, but that the US determination of the amount of subsidy was defective.

FTA Rulebook. Under US law enacted in 1992, exports of natural gas to countries with which the United States has an FTA are given special consideration – an expedited review with a presumption of approval. By contrast, LNG sales to non-FTA countries require a determination by the Department of Energy that exports are in the national interest. The rationale for distinguishing between FTA and non-FTA countries was to bring US law into compliance with the US-Canada FTA of 1989, which mandated “national treatment” for energy trade. Prior to the FTA, both the United States and Canada employed policies such as quotas, price controls and taxes to restrict bilateral energy trade. The US-Canada FTA also prohibited the use of taxes on energy exports, unless the same tax is applied to energy consumed domestically, and required that any reduction in supply be shared proportionally between the domestic and export markets (Calzonetti 1990: 174).

75 See Cimino and Hufbauer (2014b).

76 Among the Organization for Economic Cooperation and Development (OECD) countries, the United States remains the only country that continues to ban the export of most domestic crude oil (Murkowski 2014).

77 As just one example of an export restriction that was never challenged, the United States invoked the Export Administration Act of 1979 to limit exports of western red cedar logs from state and federal lands, found mostly in Washington state, as a means of supporting domestic lumber mills. By 1982 exports were completely phased out. As another example, in 2014, Indonesia banned the export of unrefined nickel and bauxite, as a means of compelling foreign firms to build refining plants in Indonesia.



The United States now has FTAs with 20 countries and these partners accounted for 41 percent of US exports in 2010. Echoing the Canada-US FTA, limitations on export controls are included in nearly all US FTAs.⁷⁸ The agreements prohibit the parties from adopting or maintaining any restriction on the export of any good, except in accordance with GATT Article XI (*General Elimination of Quantitative Restrictions*). US FTAs also prohibit the use of taxes on exports, unless the same tax is applied to the same good consumed domestically. Exceptions to these rules are included in certain FTAs.⁷⁹

However, the United States has a long history of restricting oil as well as gas exports. Exports of crude oil produced domestically are generally banned, but the Bureau of Industry and Security of the Department of Commerce (BIS) can issue export licenses under certain conditions. The surge of US shale oil production escalated industry demand for lifting the export ban. In June 2014, the DOC authorized Pioneer Natural Resources and Enterprise Products Partners to export their ultra-light crude oil, which triggered a debate on the definition of crude oil. Three policy options are now under consideration: exempting light crude oil from the export ban; removing “lease condensate” from the BIS definition of crude oil; and permitting crude oil exports for a limited period of time.⁸⁰ The Department of Commerce has yet to reconcile the crude oil export ban with US obligations under its free trade agreements.

WTO Code on Export Controls. The purpose of a plurilateral code is not so much to create new rules as to enforce existing WTO disciplines and those echoed in US free trade agreements. For practical reasons, we think the code should be limited to export restraints on natural gas, oil and minerals, and not cover foodstuffs or other natural resources. Food security is highly sensitive and for that reason alone food export controls should be the subject of a separate discussion.⁸¹ Log exports have long been banned by Canada, Indonesia and the United States, and similar bans may exist for other natural resources. Hence it seems practical to limit the initial coverage to natural gas, oil and minerals on a negative list basis – meaning that Code members could schedule agreed exceptions to their commitments.

The first commitment would call for the repeal of any export taxes or duties on natural gas, oil or minerals, and the commitments should be accompanied by WTO bindings to that effect.

The second commitment would call for the repeal of all quantitative restrictions on exports of natural gas, oil and minerals, consistent with GATT Article XI. The United States would need to reform its LNG and crude oil limitations, and other code members might need to enact similar reforms.

Digital Trade and Telecom Hardware

Overview. The digital and telecom landscape has changed dramatically since the early days of the WTO. When the Uruguay Round concluded in 1994, individuals and firms across the globe

78 The exceptions are FTAs with Israel and Costa Rica (under the CAFTA-DR agreement).

79 For example, FTAs with Australia, Colombia, Korea, Morocco, Peru and Singapore allow the United States to implement controls on the export of logs, to accommodate the US ban on exports of red cedar logs.

80 See Brown et al. (2014).

81 In an earlier report, we summarized the cost of food export controls to importing countries during the shortage years between 2006 and 2008, and suggested disciplines that would benefit poorer importers. See Hufbauer and Schott (2012).



generated about 1 petabyte (1 million gigabytes) of internet protocol (IP) traffic each month.⁸² By 2013, global IP traffic had grown to over 14,000 petabytes per month. Mobile internet usage was insignificant in 1994, but traffic originating from mobile devices alone accounted for roughly 1,500 petabytes of traffic per month in 2013. Telecom hardware has kept pace, with an enormous growth of fiber cable, satellites, servers, and associated gear. It's not surprising that digital trade – namely the purchase and sale of goods and services transmitted over the internet – was a minor concern for trade negotiators two decades ago. But as more individuals become internet users and connection speeds improve, the volume of commerce taking place over the internet will continue to expand at a rapid pace. Moreover, new technology will greatly enlarge the digital sphere. For example, as 3D printing becomes viable, the line between consumers and content producers will blur. In the future, individual consumers might find themselves procuring the services of an engineering firm for a product to be manufactured using their own equipment. As digital trade grows, so will the demand for associated hardware.

The recent rapid growth of digital commerce and associated hardware, and the promise of far more growth in the future, has kindled protectionist instincts. These instincts are intertwined with privacy and security concerns, given the commercial value of data aggregation, and the realities of spying, hacking, and back doors in digital software and hardware. Thus nations increasingly seek to guarantee a share of the digital cornucopia for their domestic firms, and their protectionist measures are either justified or reinforced by concerns over consumer privacy and commercial and military espionage.

Data and hardware localization requirements do not come free. They impose serious costs on firms, and will deter a substantial volume of potential services trade. Credit card companies, for example, usually centralize their consumer data processing and storage to save costs. These facilities need to operate consistently, robustly, and securely to ensure high quality service. When firms are required to build such centers in multiple countries, processing costs increase sharply to maintain service quality. New restrictions on data flows will not only discourage international goods trade, particularly in low value business-to-consumer (B-to-C) shipments, but also international commerce in services such as education, medical, legal and financial.

Digital Privacy. The concept of digital privacy has several aspects. Foremost, individuals and firms do not want their data hacked, as happened to servers operated by Target, Home Depot and JPMorgan. Some individuals object when corporations can access their data (for example, concerning online purchases) and use it to target advertising. Many individuals and firms would like to shield their data from the intrusive eyes of government agencies. Some individuals object when derogatory information about them can be found on Google search engines (sparking “the right to be forgotten”).

A common government response is to require the localization of servers, and to limit or forbid the transmission of certain classes of data to foreign destinations (typically the processing centers operated by multinational corporations). Such requirements clearly serve the protective purpose of fostering jobs at home. But it is doubtful that they improve on privacy beyond what could be accomplished by national laws governing protection and access to data on their citizens wherever it may be stored. Certainly they do not stop hackers located abroad (as Sony's experience with North Korean hackers illustrates). And localization requirements offer no protection against cyber espionage, a subject we now examine.

82 “Trends in Telecommunication Reform 2013: Transnational Aspects of Regulation in a Networked Society,” International Telecommunication Union, May 2013, http://www.itu.int/dms_pub/itu-d/opb/reg/D-REG-TTR.14-2013-SUM-PDF-E.pdf.



Cyber Espionage. Espionage targeted on state secrets and carried out by national governments is an old practice which has now acquired a large cyber component. Arguably newer is the use of internet networks to access secrets of private companies on a grand scale. The magnitude of commercial cyber-espionage is enormous, but even rough dimensions are elusive. General Keith Alexander, former head of the NSA, calls it “the greatest wealth transfer in history” and estimates that US companies annually lose \$250 billion through intellectual property theft.⁸³ A significant share of economic activity in the United States and other advanced countries is vulnerable to cyber-espionage. The Economics and Statistics Administration and US Patent and Trademark Office (2012) estimated that IP-intensive industries contributed around 35 percent of the US economy in 2010 and directly supported 27 million jobs.

In May 2014 the US Justice Department filed criminal charges against five Chinese military officers, claiming they hacked US corporate computer systems, trade associations, law firms and unions. The Justice Department alleges the hackers stole business plans, email communications, pricing and marketing schemes, and product designs, giving the material to Chinese state-owned enterprises (SOEs) to use for commercial advantage. Allegedly hacked were Westinghouse, US Steel, Alcoa, Allegheny Technology, SolarWorld, and the United Steelworkers union.

But concerns over spying are not one-sided. Edward Snowden’s revelations indicate that the NSA targeted China’s Tsinghua University, which hosts China’s oldest internet hub. Tsinghua currently routes data for tens of millions of Chinese users.⁸⁴ Snowden also claimed that the NSA had been intercepting millions of text messages from Chinese mobile subscribers.⁸⁵

Cyber surveillance is not always surreptitious, though it may not be disclosed to targeted individuals and companies. Theodore Moran (2014) has documented four US statutory provisions that give the US government access to domestic and international internet traffic using both software and hardware. Other governments have similar powers, though more opaque in terms of their legal authority.

Digital Hardware. Fearing the creation of foreign “back doors” in the US telecom network, the US Congress passed a law in March 2013 that could restrict purchases of information technology (IT) equipment from China. The new law sparked repercussions on the Chinese side,⁸⁶ especially since at the same time, the NSA was creating back doors into Huawei, China’s telecom giant.⁸⁷ Revelations about PRISM – the code name for NSA’s collection program – inspired the official media in China to call for a de-Cisco campaign. The state-backed *China Economic Weekly* published an article stating that eight large US IT firms had penetrated the Chinese market, calling them “guardian warriors.” Cisco was the largest target, as it has gained a market share of more than 50% in information infrastructure in key sectors such as banking, military, and government. Qualcomm, Intel, and Apple

83 Josh Rogin, “NSA Chief: Cybercrime Constitutes the Greatest Transfer of Wealth in History,” *Foreign Policy*, July 9, 2012, thecable.foreignpolicy.com (accessed on June 11, 2014).

84 Lana Lam, “NSA Targeted China’s Tsinghua University in Extensive Hacking Attacks, Says Snowden,” *South China Morning Post*, 22 June 2013, www.scmp.com (accessed on 11 June 2014).

85 Eleni Himaras, “Snowden NSA-China Hacking Claims Complicate Extradition,” *Bloomberg*, 21 June 2013, www.bloomberg.com (accessed on 11 June 2014).

86 HR 933 is a spending law with a provision requiring certain agencies to consult law enforcement authorities when considering the purchase of IT systems. The most obvious targets of this legislation are Huawei and ZTE, two giant Chinese telecom firms. In retaliation, China might restrict telecom equipment and software purchases from such companies as Lucent, Verizon, and Google.

87 David Sanger and Nicole Perlroth, “N.S.A. Breached Chinese Servers Seen as Security Threat,” *New York Times*, 22 March 2014.



were included in the list of US firms.⁸⁸ In the realm of telecom hardware, whatever liberalization might be achieved in the updated Information Technology Agreement (ITA2), will be partly offset as the United States, China, India, Brazil and other countries ramp up protection on national security grounds. Market segmentation seems a foregone outcome, unless countries can negotiate agreed protocols governing penetration of hardware and software. However an obvious point must be made: excluding foreign digital equipment and suppliers is probably not an effective means of warding off passive surveillance or active malfeasance via internet networks.

Alternatives to Protection. What can be done, by national governments and through international agreements, to answer legitimate privacy and security concerns, without resorting to protective measures that are certainly costly and almost certainly ineffective? In the next sections, we outline national self-help measures, ways to bolster WTO provisions, and possible bilateral agreements.

National Self-Help. Without limiting data flows or interrupting digital trade, national governments can enact privacy standards for personal data, and legal obligations for internet vendors. As needed, these provisions can be backed up by recourse to arbitration systems and monetary damages. The United States and the European Union have negotiated Safe Harbor provisions by which firms can ensure national governments that the privacy of personal data is properly protected. These provisions are still a work in progress, but once concluded might provide a model for other countries.

That leaves the vexing problem of theft of trade secrets across the internet – a far more efficient way of gathering information than planting spies or bribing employees. What protection can national legal systems offer against this new assault? In the United States, until fairly recently, protection of trade secrets was largely left to the states. Today 46 states have adopted the Uniform Trade Secrets Act. In principle, injunctive relief and damages for trade secret theft can be pursued in state courts, but in practice it is difficult to obtain jurisdiction over a foreign defendant and to prove cyber espionage.

US federal legal protection of trade secrets dates to 1996, when the United States enacted the Economic Espionage Act (EEA). This criminalized stealing trade secrets with the intent of benefitting a foreign government or agency, and stealing trade secrets with the intent of converting their use to the economic benefit of anyone but the owner. Because the EEA is a criminal statute, conviction requires proof beyond a reasonable doubt, and the defendant must come within the jurisdiction of the United States.⁸⁹ Around 125 EEA cases have been brought since the statute was enacted, a fairly small number.⁹⁰ While criminal penalties punish convicted miscreants, they have practically no deterrent effect on cyber-espionage launched from abroad, nor do criminal statutes compensate private parties for the harm suffered. For these reasons, Congress has explored the creation of a civil cause of action, either as part of the EEA or outside the criminal code,⁹¹ a suggestion that should be pursued by other countries as well.

88 For more see Daniel H. Rosen and Beibei Bao, "Eight Guardian Warriors: PRISM and Its Implications for US Businesses in China," Rhodium Group, 18 July 2013, rhg.com (accessed on 11 June 2013).

89 The original EEA specified the theft of trade secrets in "products." The Second Circuit Court of Appeals, reading the statute narrowly, reversed a conviction for the theft of 500,000 lines of financial code, declaring software was not a product. The Trade Secrets Clarification Act, enacted in 2012, extended the EEA to cover services.

90 "Can You Keep a Secret?" *Economist*, 6 March 2013.

91 In April 2014 two US senators introduced legislation, the Defend Trade Secrets Act, to help combat theft of trade secrets. This act seeks to protect US companies from having their trade secrets stolen by any means, including cyber-theft. The act would give trade secrets the same protection as intellectual property.



What other avenues of self-help are available? Section 337 of the 1930 Tariff Act allows the USITC to exclude imports derived from “unfair methods of competition” or “unfair acts” from the US market.⁹² Such exclusions will be granted in the case of infringements of federally protected intellectual property rights (IPRs), such as patents, copyrights, and trademarks, even without showing injury. An amendment to Section 337 of the 1930 Tariff Act could extend the exclusion to the misappropriation of trade secrets. Other countries could consider similar legislation.

A third self-help defense against cyber-espionage, mentioned in some reports cited, would authorize private corporations to “hack back” – in other words, corporations could contaminate or incapacitate the digital networks of entities that are attempting to invade their own networks. But the problems with this defense are legion: sufficient evidence of the original intrusion; harm to innocent bystanders; and proportionality of the hacking back response.⁹³

Improving the WTO Rulebook. The WTO has no obvious articles relating to data privacy, and new provisions would not be easy to negotiate. However the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which all members signed in 1994 and China accepted in 2001, creates an obligation on WTO members to prohibit, among other forms of IPR theft, cyber-espionage directed against foreign commercial firms (TRIPS Part II, section 7).⁹⁴

Moreover, the TRIPS agreement requires members to enact laws and procedures that permit “effective action” against any act of infringement, obviously including cyber-espionage (TRIPS Part III, section 1, article 41, dealing with general obligations).

But a nullification or impairment claim for breach of these requirements is not currently available under TRIPS, as such claims have been subject to a long-standing moratorium, extended multiple times. The current moratorium was again extended during the recent WTO ministerial in Bali, though pressure is beginning to build not to extend the moratorium further.

If the moratorium is allowed to lapse, as the US government urges, then properly drawn cases could give real meaning to the WTO proscription of trade secret theft.⁹⁵

92 Section 337, Tariff Act of 1930, Investigations of Unfair Practices in Import Trade, www.usitc.gov (accessed on 20 June 2014).

93 See Commission on the Theft of American Intellectual Property (2013, 81).

94 For The TRIPS agreement text, see WTO, “Agreement on Trade-Related Aspects of Intellectual Property,” www.wto.org (accessed on 11 June 2014).

95 According to the US-China Economic and Security Review Commission annual report to Congress (2013), China has agreed in a UN report that international law extends to cyberspace. This should pave the way for robust enforcement of WTO provisions. But it’s important not to go overboard. The Commission on the Theft of American Intellectual Property (2013) recommends harsh trade sanctions against China: a tariff sufficiently high to generate revenue equal to 150% of all IP losses, as estimated by the Secretary of Commerce. Based on the USITC’s central estimate of US\$48 billion IP losses in 2009, the recommended tariff revenue would need to be US\$72 billion, implying an ad valorem tariff rate of nearly 20%. An across-the-board US tariff of 20% on Chinese exports would likely inspire drastic retaliation from China, smashing both trade and investment, leading to a commercial cold war between the two countries and possibly a global recession. Less draconian and better-tailored approaches would entail sector-specific penalty tariffs, with the proceeds paid over to injured US firms.



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ICC WORLD TRADE AGENDA

The ICC World Trade Agenda is an initiative to enable global business leaders define multilateral trade negotiation priorities and help governments set a trade and investment policy agenda for the 21st century that contributes to economic growth and job creation. The initiative actively promotes a robust post-Bali trade and investment policy agenda in relevant forums, including the Business 20 and G20 discussions, and in particular at the WTO in the lead-up to and during its next Ministerial Conference.

ICC COMMISSION ON TRADE AND INVESTMENT POLICY

As trade and investment are consistently top priorities for global business, the Commission on Trade and Investment Policy represents ICC's main working body on multilateral trade and investment policy issues. The Commission examines issues that will facilitate cross-border trade and investment by business to sustain the economic recovery, job creation and sustainable development.

The mandate of the Commission is to break down barriers to international trade and investment so that all countries can benefit from improved living standards through increased trade and investment flows. The commission has 186 members from over 30 countries. They comprise trade policy specialists from ICC member companies and business representative organizations.

Senior trade policy experts from the staff of intergovernmental organizations such as the WTO, UNCTAD, and the OECD are frequently invited to address commission meeting. The Commission provides a forum for business experts to examine trade and investment policy issues and draw up policy recommendations for governments.

INTERNATIONAL CHAMBER OF COMMERCE (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

A world network of national committees keeps the ICC International Secretariat in Paris informed about national and regional business priorities. More than 2,000 experts drawn from ICC's member companies feed their knowledge and experience into crafting the ICC stance on specific business issues.

QATAR CHAMBER OF COMMERCE AND INDUSTRY

Qatar Chamber is a strategic partner of the ICC Business World Trade Agenda initiative. It is dedicated to promoting Qatar's burgeoning economy and assuring that the interests of the business community are well represented. By providing key support services, networking opportunities and leadership, the chamber has helped oversee one of the most dynamic and fastest-growing economies in the world.