



International Centre for Trade  
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OF THE WORLD

# The E15 Initiative: Strengthening the Global Trade and Investment System in the 21st Century

Ricardo Meléndez-Ortiz, Chief Executive, ICTSD  
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The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND  
INVESTMENT SYSTEM FOR SUSTAINABLE DEVELOPMENT

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# Foreword

Ricardo Melendéz Ortiz, Chief Executive, ICTSD

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The world is emerging from the global financial crisis into an era of opportunity and challenge. Global welfare, particularly in developing countries, continues to rise steadily. Technological innovation and scientific discovery proceed at a swift pace. But long-standing concerns, for example about income inequality and food security, have taken on new dimensions. Critical issues, such as climate change, resource scarcity, and the digitization of the economy, are increasingly tangible and pressing. And substandard employment and economic growth—core objectives of international trade and investment policy—are raising questions about the appropriateness and resilience of existing policy frameworks.

World trade has experienced a significant slowdown since the 2008 financial crisis. Over this period, the global ratio of trade expansion to income growth has halved. A number of structural reasons are behind this slowdown, including a slower expansion of the global value chains that changed the nature of world trade and investment in recent decades, but it is a worrying sign nonetheless.

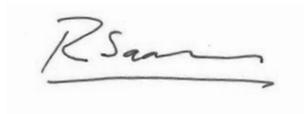
An effective global trade and investment system is crucial for reinvigorating economic growth and confronting 21st century global challenges. Yet the system—well performing as it is in many of its functions—is out of date and in need of greater coherence. Recent years have witnessed the emergence of an increasingly complex global trade policy landscape. Hundreds of regional trade agreements—including mega-regionals like the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership with potentially systemic implications—have been notified to the WTO, many with investment provisions. In addition, there are over 3,200 bilateral investment treaties and thousands more tax arrangements. At the same time, deadlock in negotiating the WTO Doha Development Agenda has detracted from the trade system's ability to respond to emerging global challenges and priorities such as the UN 2030 Agenda for Sustainable Development, the Addis Ababa Action Agenda on financing for development, and the Paris Agreement on climate change.

It is this reality that led the International Centre for Trade and Sustainable Development (ICTSD), the World Economic Forum, and 16 partnering institutions to bring together more than 375 international experts in over 80 interactive dialogues between 2012 and 2015 under the E15 Initiative. At the core of the initiative are 15 thematic Expert Groups and three Task Forces, each comprised of leading thinkers from developed and developing countries drawn from different fields and backgrounds. Their work has been complemented by an overarching dialogue looking at the global trade and investment architecture, involving consultations with hundreds of thinkers and policy-makers. The entire process has yielded approximately 150 analytical papers and its deliberations have stimulated a fresh look at the long-term challenges and opportunities facing the global trade and investment system, especially in respect of its efficacy, inclusiveness and contribution to sustainable development.

The policy option papers prepared by each E15 thematic group and presented in the second section of this volume offered a detailed and comprehensive set of suggestions for improved governance of the global trade and investment system in the 21st century. They are preceded by a Synthesis Report, which summarizes and interprets the significance of the proposals for progress on many of the international community's most important shared imperatives.

We wish to thank and salute each Expert Group and Task Force member, including particularly the Chairs, as well as the partner institutions which supported each group. Their commitment and diligence is what has made this significant contribution possible. We also wish to express our appreciation to the Initiative's distinguished Steering Committee, whose strategic guidance has been invaluable. It is important to note that not every Expert Group member necessarily agrees with every proposal or observation in their chapter, which were drafted under the responsibility of the Chairs. Nor do Expert Group and Steering Committee members necessarily agree with every representation made in the Synthesis Report, which was developed under our responsibility and does not represent an institutional position of either ICTSD or the World Economic Forum. Finally, we thank profusely the ICTSD and Forum E15 teams, including ICTSD Senior Fellow Dr. Harsha V. Singh and Senior Manager Marie Chamay as well as the Forum's Head of International Trade and Investment, Sean Doherty.

As conveners of the E15 Initiative, we have sought to provide a conducive environment for long-term strategic thinking among multiple stakeholders, regions and intellectual disciplines about the optimal evolution of the global trade and investment system in the 21st century. We believe this unprecedented process has produced a timely and relevant contribution at precisely the moment when the international community is beginning to consider a new direction. We commend it to the attention of policymakers, business leaders, scholars and citizens alike and look forward to the next phase of dialogue.

Handwritten signature in black ink, appearing to be 'R. T. T.' with a horizontal line underneath.Handwritten signature in black ink, appearing to be 'R. Sam' with a horizontal line underneath.

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#### Note on the E15 Initiative and this Volume

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to conduct a strategic review of trade and investment rules and arrangements as well as develop proposals for their evolution to 2025 and beyond. In collaboration with 16 knowledge partner institutions, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 background papers and think pieces were commissioned and published during the process.

This volume contains a synthesis report which summarizes and interprets the significance of the expert group proposals in relation to eight critical imperatives faced by policymakers, business leaders and society at large. It draws directly from expert group think pieces and policy option papers. The latter are published in a second section of this volume, whereas the former are available online at [www.e15initiative.org](http://www.e15initiative.org).

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# Strengthening the Global Trade and Investment System in the 21st Century Synthesis Report



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## Executive Summary

### *Strengthening the Global Trade and Investment System in the 21st Century*

World trade has experienced a significant slowdown since the 2008 financial crisis. Over this period, the global ratio of trade expansion to income growth has halved. An effective global trade and investment system is crucial for reinvigorating economic growth and confronting 21st century global challenges. Yet the system—well performing as it is in many of its functions—is out of date and in need of greater coherence.

It is this reality that led the International Centre for Trade and Sustainable Development (ICTSD), the World Economic Forum, and 16 partnering institutions to bring together more than 375 international experts in over 80 interactive dialogues between 2012 and 2015 under the E15 Initiative. At the core of the initiative are 15 thematic Expert Groups and three Task Forces, each comprised of leading thinkers from developed and developing countries drawn from different fields and backgrounds. Their work has been complemented by an overarching dialogue looking at the global trade and investment architecture, involving consultations with hundreds of thinkers and policy-makers. The entire process has yielded approximately 150 analytical papers and its deliberations have stimulated a fresh look at the long-term challenges and opportunities facing the global trade and investment system, especially in respect of its efficacy, inclusiveness and contribution to sustainable development.

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The recent failure by WTO member governments to reach agreement on a continuation of the Doha Round of multilateral trade negotiations has left the international community without a shared agenda for the future evolution of the global trading system. To be certain, there is no lack of initiative and innovation within the system. Regional and bilateral activity has never been more robust. But there is palpable unease about this lack of a common strategic vision and project, as well as questions about where the current dynamic of “competitive liberalization” will lead, even among its main drivers. Such questions include:

- Will the system fragment and degrade into trade-diverting regional blocs?
- Will global trade expansion continue its disappointing recent pattern of lagging global economic growth, rather than leading and propelling it?
- Will the system be able to contribute to rather than complicate progress on other global priorities, such as climate change, sustainable development, inequality, employment, population ageing, depletion of fish stocks and biodiversity, corruption and money laundering, etc.?
- Will it be able to contain the recent proliferation of non-tariff barriers, which can be just as big an obstacle to trade as the tariffs that successive multilateral rounds of negotiations have done so much to reduce?
- Will trade-related rules be able to adapt to the technological changes transforming the operating context of businesses and the very nature of commerce and investment?
- As globalization deepens, will the system succeed in striking the right balance between the policy-making prerogatives of national and local governments, on the one hand, and the logic of international economic integration and cooperation, on the other, particularly when key social values are implicated?
- In sum, will the trading system be able to maintain its essential *positive sum game* character, both in economic fact and political perception?

These questions and others have taken on heightened importance in the aftermath of the Nairobi WTO ministerial, but they have been building up within the system for some time. It is for this reason that the International Centre for Trade and

Sustainable Development and the World Economic Forum organized the E15 Initiative, a multistakeholder, long-term strategic review of international trade and investment rules and arrangements. Unprecedented in substantive scope and regional and stakeholder engagement, the Initiative convened 15 Expert Groups and three cross-cutting Task Forces, with participants from 57 countries, posing the question: how should trade- and investment-related rules and institutional arrangements evolve in each area over the next 10 years to 2025?

The groups were invited to conceive of the global trade and investment system broadly, including but by no means restricted to the WTO or other formal trade institutions and agreements. They were asked to think structurally, not incrementally, and not be bound by current calculations of political feasibility. Finally, they were instructed to be specific – to make concrete proposals and prioritize them.

A Synthesis Report created by the two convening institutions summarizes and interprets the significance of the proposals made by the Expert Groups and Task Forces. It draws directly from the policy option papers compiled by each group as well as many of the over 150 underlying research papers or “think pieces” authored by many of the 375 academic, business, civil society and governmental experts participating in the process. The Synthesis Report and individual Expert Group policy option papers are published as a single volume, and readers of the former are encouraged to delve more deeply into the latter for further detail. The think pieces, which are a remarkably rich resource in themselves, were published as they became available over the past three years and can be found on the E15 website: [www.e15initiative.org](http://www.e15initiative.org). The process has received strategic guidance from a distinguished steering committee composed of eminent scholars, business leaders and policymakers.

*Strengthening the Global Trade and Investment System in the 21<sup>st</sup> Century*  
Important shifts in the world economy and political economy of trade policy in recent decades have resulted in an increasingly fragmented and sometimes trade-diverting system that has moved off the centre of the stage of international economic cooperation and is losing legitimacy and relevance for key constituencies. A new common agenda is required that can reset the trajectory of the system’s evolution in ways that equip it to respond tangibly to contemporary concerns that are top of mind in Cabinets, boardrooms and kitchen tables around the world.

The output of the E15 Expert Groups and Task Forces is encouraging in this respect. Their proposals demonstrate that an agenda to strengthen and update the system is not only conceivable but also plausible. As synthesized and interpreted in the following chapters, they form a blueprint for how the international

community could come together to make progress on each of the following shared imperatives through improvements in trade and investment rules and arrangements:

*Boosting Global Growth and Employment*

*Reducing Commercial Friction and Investment Uncertainty*

*Accelerating Sustainable Development in Least Developed Countries*

*Increasing Economic Diversification and Competitiveness in Middle-income Countries*

*Ensuring Food Security*

*Combating Climate Change and Environmental Degradation*

*Preserving National Policy Space to Make Societal Choices*

*Strengthening the Legitimacy of the Global Trading System*

The substantial nature of the proposals that have emerged in each of these areas suggests that there are important, potentially even transformational, benefits in this agenda for every region and major constituency. **Just because the world was not able to agree to the particular multilateral agenda on the table in the Doha Round does not mean that a common (as opposed to single) undertaking that leaves each better off is not possible.**

However, the path toward deeper and more effective international trade and investment cooperation in the 21<sup>st</sup> century only comes into view if one steps back from a specific focus on the WTO and appreciates the much wider ecosystem of institutions and instruments available to influence trade and investment behaviour. The proposals summarized below take such a systemic view, spanning a wide range of disciplines and institutions in a way that contrasts with most trade policy analyses, including the two formal reviews commissioned since the turn of the century by the WTO. Embracing a broader frame of reference and deploying a much wider array of tools available for international economic cooperation is fundamentally what will make a *positive sum game* outcome possible in the current, more complex, economic and political context.

This insight has important implications for national and international governance. The agendas of trade ministers and institutions need to be embedded in larger strategies set by higher authorities that integrate other policy and stakeholder dimensions. This will be the focus of the next phase of the E15 Initiative -- a dialogue around the world about the implications of this blueprint for how trade and investment policy is set and administered in countries and at the global level -- and how improvements in international cooperative architecture could help.

## Boosting Global Growth and Employment

Were the world economy able to return to its historical pattern of international trade and output growth in which trade expands at about 160% of the rate of economic activity, global growth would be nearly a full percentage point (i.e., one-third) above currently forecasted levels. International trade and investment contribute to growth by facilitating the flow of capital, labour and particularly technology to their most productive uses across the world economy. E15 Expert Group proposals would increase the global diffusion of productivity-enhancing technologies, improve the allocation of the capital and skills to their most productive potential applications and expand trade and investment in employment-intensive industries.

### Diffusing Technological Progress

#### **Scale Internet-enabled SME trade:**

- Adopt interoperable, digitally-enabled **single windows for customs and border compliance**, and releasing open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows supported by an expansion of Aid for Trade capacity-building assistance for developing countries.
- Create comprehensive, **online, single points of enquiry for cross-border services providers** to learn about host country regulatory, licensing and other administrative requirements.
- Establish higher, standardized **de minimis customs levels** to facilitate cross-border flows of small packages supplied by internet-enabled retail services providers, especially SMEs, for example by adopting the APEC \$100 (or even \$200) minimum common threshold for developing countries and higher threshold, such as \$800, for advanced countries.

#### **Establish clear rules pertaining to the electronic transmission of data and related services:**

- Allow the **free flow of data across borders** subject to an exceptions provision based on the General Agreement on Trade in Services (GATS) Article XIV concerning the right of countries to protect the privacy of personal data as long as such right is not used to circumvent the provisions of the agreement.
- Establish regulatory certainty and coherence by **aligning rules with leading practices** regarding intermediary liability, privacy, intellectual property, consumer protection, electronic signature and dispute settlement.
- Establish a **permanent moratorium on the imposition of customs duties on the electronic transmission** of products.

***Initiate negotiations to establish a Plurilateral Digital Trade Agreement or “eWTO”:***

- A forward looking group of countries from various regions should take the initiative to create an **agreement to implement a comprehensive set of policies and leading regulatory and multistakeholder practices such as those outlined above**, to maximize the growth and employment potential of Internet-enabled trade. If such a group included, among other countries, the United States, China and European Union, its provisions could be extended on a most-favoured-nation basis to all countries as a “critical mass” agreement under WTO rules, serving as a thereby a powerful stimulus to global growth and employment particularly in the SME sector.

***Create a WTO Working Group on Digital Trade*** to examine how the needs of digital trade are now covered under the existing rule framework, identify areas where coverage is inadequate or ambiguous, and recommend appropriate clarifications or adjustments.

***Include research services in GATS and establish an Agreement on Access to Basic Science and Technology*** aimed at strengthening the global commons in science and technology without unduly restricting private rights in commercial technologies.

Improving the Global Efficiency of Capital and Labor Allocation

- ***Ensure correspondent-banking availability in developing countries***, which has decreased as a result of the tightening of Know Your Customer (KYC) requirements, by ensuring that the BIS, FSB or Wolfsberg Group mentored or sponsored at least one bank per country for purposes of validating its KYC process.
- ***Deepen regional regulatory cooperation in financial services***, including through the creation of regional credit bureaus and rating agencies, facilitation of free data flows and offshoring and standardization of documents and documentation requirements.
- ***Scale the blended (public-private) financing of infrastructure and industrial investment*** through expanded deployment of risk mitigation, co-financing, capacity building assistance and other public finance tools.
- ***Streamline processes and procedures related to visas and work permits and establish a plurilateral but open “innovation zone”*** working through GATS within which skilled researchers and technical personnel would be able to migrate freely for up to 10 years.

### Expanding Trade and Investment in Employment-intensive Industries

- **Develop a comprehensive WTO Framework for Trade Facilitation in Services**, with attendant measurable indicators as in the Trade Facilitation Agreement. This Framework should encompass both cooperative and negotiating mechanisms, complemented by capacity building and technical assistance.

### Reducing Commercial Friction and Investment Uncertainty

A large and growing share of the world's economic activity is organized through global value chains (GVCs) and strategic networks, rather than through arm's length sales between vertically integrated buyers and sellers in different countries. The most obvious evidence of that trend lies in the percentage of world trade made up of intermediate goods – a *nearly 60% share of world imports and close to three-fourths of the imports of large developing economies, such as China and Brazil*. In this networked world, steps aimed at increasing the quality and reliability of goods and services, decreasing time to market, and enhancing the ability to innovate matter more than lowering the price wedge that tariffs can create. Enabling local firms' participation in GVCs requires a focus on improving both an economy's "hardware" (for example, transportation and communications infrastructure) and its "software" (e.g., institutional arrangements, quality and safety standards; improvements in customs procedures, and so on).

- **Establish a Global Value Chain Partnership**, a public-private platform to improve the efficiency and inclusiveness of global supply chains. The platform would facilitate cooperation between governments seeking to integrate their economies into international supply chains and the companies and experts who could be their partners. The action orientation of the partnership would be underpinned by important new analytical efforts to map existing value chains and impediments to their expansion in new geographies as well as to assemble evidence and examples of good practice that can inform the strategies of developing country governments to maximize the contribution to sustainable development of their economies' participation in these production networks.
- **Simplify the conduct of business across the more than 400 existing regional and preferential trade agreements** through an **RTA (regional trade agreement) Exchange**. This comprehensive open information platform would aim to enhance transparency and understanding about the similarities and differences of RTAs, encouraging a dynamic of learning, best practice adoption and cooperation that leads ultimately to the alignment and even multilateralization of subsets of their rules.
- **Simplify the conduct of business across the more than 3,200 existing international investment agreements (IIAs)** through development of a **Model Investment Agreement** for the 21<sup>st</sup> century world economy. The

Investment Policy Framework for Sustainable Development recently issued by UNCTAD could serve as a starting point for this process, which would seek to build common ground on not only the articulation of and set of definitions for this restatement of the purpose of IIAs but also the design of the main elements of a 21st century international model agreement, using as building blocks a few of the more recently concluded bilateral agreements and perhaps the prospective US-China bilateral investment treaty that is under negotiation. This new model framework, formulated as a best practice open for voluntary adoption, would be a bottom-up way to spur the modernization and harmonization.

- **Strengthen the transparency of national regulations.** Transparency obligations in the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) Agreements are the most far-reaching in the WTO regime. One-stop shops, enquiry points, intervals between the preparation and adoption of measures coming under the aegis of the two agreements constitute important innovations. Regulation, however, extends to areas not covered by the TBT and SPS Agreements. A new, consolidated framework on regulatory transparency should be agreed in the WTO in which:
  - There is a “mapping” of national mechanisms that are intended to provide transparency with respect to various national regulatory processes.
  - WTO members notify all adopted measures, whether based on international standards or not;
  - They explain the rationale behind their measures (“reasoned transparency”).
  - They involve affected parties at an early stage in the process.
  - Business is provided observer status in the TBT, SPS and other Committees.
  
- **Integrate services and goods in policy by deepening the Trade in Value Added research of the OECD and WTO and establishing a WTO Working Group** to recommend ways to reduce distortions resulting from the separate rules for goods and services, which are increasingly out of step with the transformation of economic activity in many sectors in which services are embedded in products.
  
- **Build upon the competitive neutrality principles for state-owned enterprises included in the Trans-Pacific Partnership and EU-Canada CETA agreements** by expanding application of these provisions to other RTAs.
  
- **Improve cooperation among competition and trade policy authorities** by inviting national competition authorities to evaluate the competition consequences of national decisions bearing on tariffs, antidumping, government procurement, foreign direct investment, services regulation and so forth. In addition, informal discussions in the International Competition Network (ICN),

OECD and UNCTAD should be deepened, concentrating on multi-jurisdictional mergers as the most likely source of consequential, inconsistent decisions. Agencies could voluntarily, but effectively, collaborate in joint investigation and enforcement.

## Accelerating Sustainable Development in Least Developed Countries

### **Maximizing Preferential Market Access**

- **Developed countries should extend full Duty Free Quota Free (DFQF) market access for all LDCs.** The European Union, Canada and Japan have essentially met this objective. A phased programme could be devised by the United States to address the small number of apparel tariff lines that are important for Sub-Saharan African exporters and covered by the African Growth and Opportunity Act.
- **Middle-income countries should follow the leadership of China, India and Brazil by implementing DFQF programmes that attain 97% tariff line coverage** within the next 5 to 10 years. China expects to reach this goal by the end of 2015 for LDCs with which it has diplomatic relations. Other middle-income countries should demonstrate a similar degree of commitment to South-South trade and the eradication of absolute poverty by following suit.
- Both groups of countries should follow the leadership of Canada and **implement rules of origin for these preference arrangements using an extended cumulation approach, forming, in effect, a broad cumulation zone** among all LDCs and countries that are members of free trade agreements (FTAs) in which the importing country participates. This approach would significantly stimulate exports from LDCs, judging from the evidence of similar rule of origin changes in the past.

### **Improving the Terms of Foreign Investment**

- Use the Investment Policy Framework for Sustainable Development recently issued by UNCTAD as a starting point for the development of a **Model Investment Agreement** as described in the preceding section, including:
  - An articulation of **fundamental investor obligations**, including with respect to responsible business conduct in areas like corruption, human rights and taxation (i.e. for example, the new OECD Base Erosion and Profit Shifting framework) and benefit sharing. Supplemental sector-specific responsible investment frameworks could be developed through public-private dialogue, such as in the area of responsible mineral and natural resources development;
  - A new **international appeals framework** that states could choose to opt into as part of their bilateral agreements or FTAs. This mechanism would provide recourse for either party of an arbitral judgment to an ad hoc appellate body composed of members from a pool of investment adjudication specialists accredited by the international framework.

- Establish an **Advisory Centre on International Investment Law** to level the playing field for developing country governments that lack the legal expertise to defend themselves adequately in disputes, based on the model of the Advisory Centre on WTO Law.
- Expand donor country assistance to support for **capacity building to developing countries** in the implementation of the new model framework. This can be done by extending the WTO Aid for Trade initiative to cover investment-related as well as trade-related capacity building. These programmes of assistance could be shaped by the Investment Policy Reviews of UNCTAD or relevant reviews by OECD or the WTO.
- Scale **technical assistance from the International Monetary Fund or multilateral development banks to LDC sovereign debt issuers** to ensure they have the capacity to negotiate terms based on the model frameworks developed recently to eliminate judicial/sovereign risks, and in turn provide for efficient restructurings should the need arise.

### ***Expanding the Inclusivity of Norm Setting and Adoption***

- **Establish regional institutions for structured support programs to enhance local capacity** to conform to global standards, and provide links to lead firms to increase understanding of international market developments.
- Develop norms for making regional and plurilateral agreements more inclusive. In addition to more permissive rules of origin, devise methods or principles by which the multilateral system could accommodate newly emerging trade regulatory regimes.

### ***Increasing Financing for Trade-Related Development***

- **Expand the scope and scale of trade-related capacity building assistance** and the Aid for Trade initiative. Several E15 Expert Groups proposed major increases of such aid for the development of rules and administrative and adjudicatory capacity in the areas of services, legal and regulatory reform, investment frameworks, private standards adherence, responsible supply chain practices and labor, environmental and anti-corruption institutions, etc. While the Aid for Trade initiative has made important progress since it was launched 10 years ago, it and related bilateral donor programmes need to substantially broaden their scope and considerably boost funding levels so that a fuller spectrum of institutional weaknesses that raise trade costs and create investor uncertainty.
- **Deploy official development assistance (ODA) more strategically in further ways**, particularly by increasing use of blended finance to catalyze private investment and creating a more business-friendly policy environment through the strengthening of institutional capacity in the financial sector and public expenditure, tax and judicial systems. In particular, concrete steps could be taken to increase efforts to support implementation of OECD BEPS measures (e.g., with modest international support, Kenya's revenue collection from transfer pricing audits doubled recently from \$52 million to \$107 million)

- **Establish an agricultural subsidy solidarity fund** to support food security and climate change adaptation in LDCs, in which financial contributions would be made in proportion to the magnitude of such domestic support in advanced and emerging countries. With total ODA to agriculture in the order of \$9 billion and official trade-distorting support (OTDS) to agriculture in these countries amounting to about \$200 billion, a contribution of even just 1% or 2% of OTDS by each donor country would result in an expansion of ODA to agriculture by 20% to 40%, funds that could support a significant boost in capacity-building assistance for climate-smart agricultural productivity improvements and export performance in at-risk LDCs.

### Increasing Economic Diversification and Competitiveness in Middle-Income Countries

Middle-income countries (MICs) face growing competition in traditional markets from other developing countries and the challenge of boosting their technological sophistication in order to compete effectively with advanced countries in higher value-added products and services. The best way for MICs to avert this so-called middle-income trap is to improve domestic competitiveness at the level of the firm, industry and the nation itself.

The evidence regarding industrial development over the past 50 years, including particularly the experience of a number of successful East Asian economies, suggests that horizontal (non-sector specific) policies to improve the enabling environment for private sector development are ultimately more important to success than vertical (sector- or firm-specific) ones. In particular, by **combining improvements in infrastructure, investment climate institutions and workforce skills with openness to foreign direct investment** in key sectors, countries create the possibility for technology and know-how from those foreign firms to be transferred more widely and organically through the bottom-up creation of forward and backward linkages. These linkages can build over time into clusters of industrial capabilities that propagate local production, investment and innovation. This dynamic can be accelerated by attracting investments by lead firms in global or regional value chains through the maintenance of an enabling tariff and non-tariff barrier environment for the importation of key inputs and improvements in trade facilitation (particularly customs administration and logistics). In this sense, **modern industrial policy emphasizes the facilitation rather than restriction of imports and inward foreign investment**. Vertical policies can also be helpful, but based on a recognition that they are more likely to be effective and cost-efficient if executed within a robust horizontal enabling environment and determined through a **rigorous and dynamic evaluation of the country's latent competitive advantages** that is insulated from rent-seeking behaviour of vested interests.

E15 Expert Groups propose several ways in which the international trade and investment regime can be strengthened to help countries translate enabling environment improvements into increased flows of foreign investment and commerce which contribute to economic diversification and industrialization. Rather than creating new rules, much of this agenda concerns facilitation, particularly of cross-border investment, services trade and integration into global value chains, as these are vehicles for introducing additional capital, technology, know-how and skills transfer into an economy. Specifically:

**Create an international support programme for sustainable investment facilitation**, focused on improving *national* FDI regulatory frameworks and strengthening investment promotion capabilities. In a world of global value chains, the Aid for Trade Initiative and the TFA address one side of the equation, namely the trade dimension; an international support programme for sustainable investment facilitation would address the other through enhanced transparency of both host government rules and practices as well as an expanded array of promotional services.

- One option would be to extend the Aid for Trade Initiative to cover investment or create a separate Aid for Investment initiative. The initial emphasis could be on investment in services, with a focus on sectors key to promoting sustainable development, such as environmental services, energy, transportation, and professional services
- Another, more ambitious, and medium-term option would be to expand the Trade Facilitation Agreement to cover sustainable investment as well, to become an Investment and Trade Facilitation Agreement, conceivably through an interpretation of that Agreement or through amending that Agreement.
- A third option is for a group of interested countries to launch a Sustainable Investment Facilitation Understanding that focuses entirely on practical ways to encourage the flow of sustainable FDI to developing countries. Work on such an Understanding could be undertaken in the WTO or within another international organization with experience in international investment matters, perhaps UNCTAD or the World Bank or the OECD. Or, a group of the leading outward FDI countries could launch such an initiative, perhaps through the G20.

Several of the proposals presented in the three preceding sections would also contribute strongly to economic diversification and competitiveness in middle-income countries, namely:

- **Establish a Global Value Chain Partnership** to expand the efficiency and inclusiveness of international supply chains through sectoral mapping, development impact analysis and facilitation.
- **Promote international trade in services and SME exports** by:
  - Helping countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing and other administrative requirements and tasking an international organization or independent agency to benchmark country progress.

- Help countries to implement the Trade Facilitation Agreement and adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms for services that seamlessly link SMEs to large numbers of country single windows.
- Encourage the establishment of higher standardized *de minimis* customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers, especially SMEs.
- **Improve Regulations and Standards**
  - Develop human capital and allow the movement of skilled workers. Establish an innovation zone within which skilled researchers and technical personnel would be able to migrate freely.
  - Strengthen competition monitoring and establish competition best practices and cooperation.
  - Update the WTO telecom reference paper to regulate competition that affects Internet access and competition over the Internet.

In respect of vertical industrial policies:

- **Soften and monitor local content requirements.** Local content requirements (LCRs) could be “softened” by broadening them to encompass inputs from regional economic communities, strengthening regional value chain development. But at the same time, WTO notification should be required for formal LCRs and captured in the trade-monitoring database, with regular review via the Trade Policy Review Mechanism. Research should be undertaken to improve understanding of the conditions required for LCRs to achieve the objective of generating positive spillovers for the local economy. Finally, conversion of the WTO LCR prohibition into an “adverse effects” test similar to the regulatory system for domestic subsidies could be considered for some LCRs.
- **Allow non-actionable subsidies** related to publicly available R&D, regional development, environmental protection and disaster recovery by reviving a revised form of Article 8 of the ASCM.

## Combating Climate Change and Environmental Degradation

The international community has resolved through the 2030 Agenda for Sustainable Development to protect the planet from degradation, including through sustainable consumption and production, sustainable management of natural resources and urgent action on climate change. The obvious links between trade and environmental outcomes require a convergence between regimes. In particular, work is needed to create additional clarity and space for climate measures that countries implement to carry out their commitments under the recent Paris UN climate change accord:

- **Establish a process involving the WTO and UNFCCC to assess and make recommendations for the trade-related legal implications of the Paris**

**accord**, for example through the WTO Committee on Trade and Environment and a subsidiary UNFCCC scientific body. This process should produce a **clear definition of what constitutes a climate action under the Paris accord for purposes of informing WTO dispute settlement**. It could also lead to creation of a UNFCCC dispute settlement mechanism to adjudicate disputes relating to this definition as well as an interim “peace clause” on trade law challenges to certain measures. And it should consider the extent to which WTO dispute settlement should defer to trade-related climate accords adopted by the International Maritime Organization and International Civil Aviation Organization.

- **Encourage the consistency and inter-operability of national climate change mitigation strategies** by:
  - Developing international standards for carbon accounting, including for carbon embedded in products and services
  - Creating a waiver from WTO obligations for certain climate measures targeting embedded carbon
  - Recognizing certain carbon taxes as indirect taxes under GATT Article II or creating a bespoke waiver for them
  - Clarifying that the exemptions under WTO Article XX apply to protection of the world's climate as a means of facilitating the creation of nationally determined emissions trading schemes and related border adjustment mechanisms that meet certain common criteria.
- **Facilitate the creation of higher ambition climate clubs within RTAs or new plurilateral arrangements** (such as the carbon pricing club of countries announced in Paris) by including in the WTO code of conduct for plurilateral arrangements described below an affirmation that club members may accord each other WTO-plus benefits or discriminate in certain ways against non-members.
- **Mandate within the WTO the disclosure and phased prohibition of fossil fuel subsidies**, according special and differential treatment to poorer developing countries.
- **Extend the ongoing Environmental Goods Agreement negotiations** to certain services and NTBs, while extending tariff liberalization in a second phase to a broader range of environmental goods.
- **Discourage overuse of trade remedies against public support for clean energy technology development** by making climate change a criterion in public interest tests, extending GATT Article XX on General Exceptions to such subsidies, creating a permanent climate change exception under the SCM Agreement or agreeing a clean energy waiver; and **clarify the treatment of energy flows** (e.g. classification of electricity as a good or a service) to provide

greater certainty to energy markets.

- **Develop a sectoral agreement on trade in finite natural resources**, as exists for agriculture, due to the trade and investment specificities and development importance of the mining, oil and gas sectors.
- Address, through multilateral negotiation, the current legal vacuum on **export restrictions and level the playing field with respect to export taxes** for natural resource products between newly acceded countries to the WTO and original members.
- **Build on the momentum of recent national and public-private initiatives and the important elements of the TPP agreement to reduce fisheries subsidies and address Illegal, Unreported and Unregulated (IUU) fishing** by establishing a cooperative network of such schemes. The aim over time would be to strengthen and link them through trade agreements and/or in mutual recognition standards arrangements in a manner that could eventually close off the global market for illegally caught fish.

## Ensuring Food Security

Food security considerations have been upended by the emergence of a new normal in agricultural prices. Extreme price volatility has encouraged insulating policies that erode confidence in global markets while domestic support has seen a resurgence. As the primary means of livelihood for large, impoverished populations and with the growing challenge of water stress related to climate change, agriculture need to be addressed with care in trade policy.

- **Undertake confidence-building, non-binding commitments among governments** to rebuild trust, starting with time-limited pledges not to exceed domestic support levels that are at or above current levels but below bound rates, and moving in a second step market access.
- **Initiate plurilateral negotiations among major, like-minded countries on domestic support and market access** that, depending upon the countries engaged and commodities covered, could lead either to a closed agreement along the lines of the WTO Government Procurement Agreement or an open, critical mass agreement providing its benefits to all countries.
- **Discipline export restrictions** in the WTO to avoid price spikes and maintain confidence in the reliability of international markets as a reliable source of food. In the first instance humanitarian aid should be exempted from export restrictions as covered in the Nairobi agreement. Current disciplines should be made enforceable, while in the longer term export taxes and restrictions could simply be prohibited.

- **Support the establishment of emergency humanitarian food reserves** to prepare for times of crisis by updating the 1986-88 fixed reference price used for calculating the level of permissible domestic support and clarifying that if the administered price is below the market price then the support measure would be considered green box compatible (i.e., not an actionable subsidy). To address longer-term food insecurity a system of global food stamps or similar approaches, such as the “transfers to cover the poverty gap” proposed by the FAO, the International Fund for Agricultural Development (IFAD) and the World Food Programme (WFP), are worthy of attention.
- **Drive transparency in agricultural market data and government support** to avoid trade distortions. All nations should provide requested data to the Agricultural Market Information System and notify, in particular, support to biofuels more comprehensively. On the basis of this added transparency, consideration should be given to distinguishing between public-good and income-maintenance “green box” subsidies, with the latter possibly subject to some limitations.
- **Expand facilitation of agricultural trade**, not least domestically and regionally, by broadening the focus of the Trade Facilitation Agreement to hard and soft agricultural supply chain infrastructure as well as the **use of international sanitary and phyto-sanitary standards**.
- **Promote an integrated Agri-Food Value Chain approach to future negotiations** to provide an opportunity to address relevant aspects in an integrated manner, ranging from tariffs and non-tariff barriers, services related to agriculture (e.g. storage, handling, shipping or processing), seeds, pesticides and fertilizers, trade facilitation, transport and logistics, innovation and ITC.

## Preserving National Policy Space to Make Societal Choices

There is rising concern among some countries and constituencies that international trade and investment liberalization have gone too far in the sense of unduly restricting the ability of governments to pursue critical national objectives that their societies may value as much as or more highly than the facilitation of cross-border trade and investment, in particular industrial development and certain social values in such areas as public health, environmental protection, labour and human rights, consumer protection and cultural heritage.

The Expert Group on Reinvigorating Manufacturing concluded that **for the most part international trade disciplines still do not pose a significant barrier to the kinds of industrial development strategies that have proved effective in places such as South Korea, Taiwan, China and India**. This is principally because a) while multilateral disciplines do exist and have been tightened in some respects in recent years regarding “vertical” or industry-specific policies (notably,

intellectual property rights), most such strategies are still available to developing countries on either a *de jure* or *de facto* basis; and b) the most effective policies for spurring industrial development have in fact proved to be “horizontal” (not industry specific) in nature, and these measures are essentially unconstrained by international trade and investment disciplines.

As for domestic policy autonomy in respect of social values, the current controversy over investor-state dispute resolution is a manifestation of a wider question about the appropriate limits of international economic integration, in particular a new generation of FTAs that involve much deeper integration of economies. By virtue of their emphasis on investment and services, these new trade initiatives are increasingly focused on improving regulatory coordination, sometimes on topics for which societies have differing or still-evolving underlying value systems (e.g. precaution, privacy, industrial relations, etc.). **The essential question such deeper integration poses is: what is the right balance between investor and citizen rights, investment certainty and democratic due process, and regulatory coherence in a highly-integrated world economy and deference to legitimate national values and choices?** E15 Expert Groups propose several ways in which the trade and investment rules and institutions could be improved to support a better balance:

- **Modernize and strengthen the coherence of investment agreements** as outlined above. The proposed new Model Investment Framework, formulated as a best practice open for voluntary adoption, would include a number of specific additional innovations that would help negotiating parties to strike a better balance regarding the preservation of essential national policy space, including:
  - An articulation of **fundamental investor obligations**, including with respect to responsible business conduct in areas like corruption, human rights and taxation (i.e. for example, the new OECD Base Erosion and Profit Shifting framework). Supplemental sector-specific responsible investment frameworks could be developed through public-private dialogue, such as in the area of responsible mineral and natural resource development.
  - A new **international appeals framework** that states could choose to opt into as part of their bilateral or FTA agreements. This mechanism would provide recourse for either party of an arbitral judgment to an ad hoc appellate body composed of members from a pool of investment adjudication specialists accredited by the international framework.
  - A new **dimension of citizen participation** modelled on the OECD Guidelines for Multilateral Enterprises. Specifically, a Consultative Committee for the new model framework could be established for the purpose of providing input into not only the elaboration of the framework but also its implementation. Various stakeholders could be accorded consultative status to identify and offer analysis of specific dispute settlement cases that they believe illustrate the need for further clarification or the evolution of the framework going forward.

- To help level the playing field for developing country governments that lack the legal expertise to defend themselves adequately, an **Advisory Centre on International Investment Law** should be established, modelled on the Advisory Centre on WTO Law. Created in 2001, this provides services to developing countries through its own staff or outside counsel at reduced rates.
  
- **Create a safe harbour for subsidies to address market failures.** The E15 Initiative Task Force on Subsidies made a set of additional proposals that would clarify (and thereby increase) the latitude governments have to address market failures or create public goods. They propose reinstating a modified version of Article 8 of the Agreement on Subsidies and Countervailing Measures concerning Non-Actionable Subsidies that expired in 2000. This would create a safe harbour for the use of subsidies that address four social objectives on the grounds that these are problems of the commons or other market failures whose remediation would have positive externalities: mitigation and adaptation to climate change; inclusion of marginalized regions; promotion of publicly available R&D; and recovery from natural disasters and conflict.
  
- **Promote the levelling up of social and environmental standards** over time through regulatory cooperation among self-associating clubs of countries and the parallel scaling of responsible supply chain practices by multinational and other companies. In particular:
  - Encourage like-minded countries to form open clubs that establish a common floor for such standards and help other countries join by extending trade and investment preferences and substantial capacity-building assistance to them.
  - Multinational enterprises be encouraged and even expected by their home governments and shareholders to **apply to their operations abroad the basic worker rights and pollution control rules to which they are subject in their home country**. This would go a long way towards addressing the concern in advanced countries about the implicit subsidy or artificial advantage represented by weaker standards in poor countries without prescribing legal and institutional changes that would impinge on domestic policy autonomy.
  - The **new initiative by G7 countries to spread responsible labour and environmental practices throughout the worldwide supply chains of companies headquartered in their countries should become a rallying point for public-private cooperation** to scale the voluntary application of best practices through a combination of governmental jawboning of the type suggested above and funding of developing country technical assistance and outreach. A concentrated effort over the next two to three years could build a critical mass of corporate adherence within most key industrial sectors.

## Strengthening the Legitimacy of the Global Trading System

Three features that have historically underpinned the global trade system's legitimacy are widely perceived as being eroded. First is the bedrock principle of *non-discrimination*, which has guided the construction of a rules-based multilateral framework open to broad participation, ensuring the system has the character of a global public good. Second is the notion that the system is a *means serving larger ends*, in particular the objective of sustainable development but also other societal priorities determined by national polities. Third, the long Doha Round stalemate during a period of dramatic transformation of the world economy has raised the question of whether the system remains sufficiently *adaptive and fit for purpose*.

**Inclusiveness:** Five sets of proposals have emerged that would particularly help to reinforce the universality or inclusiveness of the system's benefits. These would help to ensure that the variable geometry made necessary by the complex economic and political landscape of the 21<sup>st</sup> century evolves in a way that encourages the widest possible inclusion of countries in such "clubs" (or key elements thereof) in the near term as well as the progressive integration of such regional and plurilateral arrangements (or key elements thereof) into a growing body of non-discriminatory multilateral norms over the medium to long term.

Establish the **RTA Exchange, Model Investment Agreement; and Regulatory Transparency** procedures outlined in previous sections.

Launch a formal process of negotiations to create a **WTO "code of conduct" for plurilateral agreements** that enshrines a specific set of proposed principles and rules.

Draft **Multilateral Impact Statements** for regional arrangements that would examine the extent to which such agreements (a) create contestable markets that provide benefits to outsiders as well as participants, and (b) serve as the modular components of a more integrated global trading system. One mechanism for establishing this practice would be for an independent authoritative body—either a think tank or distinguished panel of trade authorities perhaps commissioned by the RTA Exchange described above or the WTO—to lay out a set of relevant criteria and then to apply these to an analysis of RTAs.

These initiatives, in addition to the proposal above for all countries to follow the leadership of Canada and **implement rules of origin in preference arrangements using an extended cumulation approach for LDCs** (forming, in effect, a broad zone linking all LDCs with countries participating in particular FTAs), would have the combined effect of carving a constructive path for the system out of the current "spaghetti bowl" of fragmentation. They could set in motion a self-reinforcing dynamic of **modular multilateralization** in which individual regional and plurilateral rules are progressively reintegrated at the multilateral level over the next 10 to 20 years.

**Synergy.** The E15 Initiative has proposed many ways in which the global trading system could be strengthened to maximize its contribution to and minimize the complications it creates for the wider sustainable development agenda. These have been summarized particularly in three of the preceding chapters:

- *Boosting global growth and employment*
- *Accelerating sustainable development in least developed countries*
- *Combating climate change and other environmental degradation*

If the international community were to adopt the reforms outlined in these chapters, it would render the international trade and investment regime a much more potent force for progress on three of the most pressing global challenges of our times. Well beyond promoting coherence in the bureaucratic sense, these three sets of proposals would enlist the global trading system as a full partner---an accelerator of action---on each, in so doing enhancing the system's relevance and legitimacy for all countries.

**Effectiveness.** E15 Initiative Expert Groups would boost the delivery and effectiveness of the global trade system by expanding the array of negotiating approaches at the disposal of governments within the WTO as well as widening the set of tools available to generate forward progress beyond such norm-setting negotiations, per se. The agenda summarized above spans approaches that are:

- *multilateral, plurilateral and unilateral*
- *formal and informal (including greater use of best endeavours frameworks linked to increased capacity building assistance)*
- *uni-disciplinary (trade rules and institutions) and multi-disciplinary (involving multiple international organizations and ministry portfolios)*
- *new approaches to longstanding challenges (e.g., domestic agricultural support, special and differential treatment through trade preferences)*
- *new approaches to new challenges (e.g., digital economy, investment, services, climate change, competition, social standards)*

Such a results-oriented, multi-dimensional approach will only be possible if the trade policy community and the WTO in particular conceive of themselves as embedded in a wider global trade and investment system. Rather than seeing this complex variable geometry as an intrinsic threat or even rival, they must conceive of the WTO as fundamentally embedded in rather existing above or apart from it, indeed *servicing* the wider ecosystem by assuming a greater sense of responsibility for its positive evolution through the execution of an expanded array of leadership functions.

### **The Future of the WTO**

Partly because of its origins in the GATT, the WTO's institutional culture is somewhat inward looking---the custodian of multilateral rules arrived at through multilateral negotiations. This remains a critical function, but the international community requires more from the WTO in the 21<sup>st</sup> century. The WTO's own

general principles as reflected in the preamble of its Charter also require more of it in this new context. Only if the institution's role is broadened from that of a framework for negotiations of reciprocal concessions and the settlement of disputes thereunder to *an enabler of the wider system's contribution to cross-border trade- and investment-related economic development* will the comprehensive set of opportunities for global trade summarized in the preceding chapters be realized and the fundamental legitimacy of the system be assured.

**Informal Cooperation.** There is much more the WTO should do in the areas of data, transparency, analysis, dialogue and facilitation of both normative coherence and expanded trade and investment flows in the service of economic development:

- **Strengthen the role of WTO Committees**, making them active platforms for deeper analysis and more productive *informal* dialogue (endnote think piece). This would entail extending the terms of Chairs and Vice Chairs from one to two or three years and empowering the corresponding secretariat directorates to be more proactive and independent in the structuring of their research agendas. There are multiple opportunities for the WTO to influence the course of national policy and even regional and plurilateral arrangements in this way.
- **Leading or otherwise participating actively in informal facilitation initiatives**, such as the Global Value Chain Partnership and possible Services and Investment Facilitation frameworks summarized above. These initiatives and others like them would combine evidence-based dialogue among governments, businesses and experts with the possibility of institutional capacity building assistance for developing countries that seek to capitalize on industrial development opportunities that the analysis and dialogue help to identify. As such, they have the potential to be just as catalytic of trade and investment flows as formal new trade agreements.
- **Leading or participating actively in informal anti-fragmentation initiatives**, such as the RTA and Investment Agreement Exchanges as well as enhanced regulatory transparency platform described above. These exercises and others like them seek to create an open-source dynamic of transparency, peer exchange, learning and reform. They can be a powerful force for improved consistency, convergence and ultimately the integration of regional and plurilateral arrangement rules into an ever-expanding core of multilateral disciplines.

**Formal norm creation.** The WTO would stand a better chance of catalysing the progressive reintegration of the system over the next 10 to 20 years through the **modular multilateralization of specific features of RTA and plurilaterals** if it was similarly creative and pragmatic about its negotiating function. It could do so by encouraging the creation of plurilateral clubs that are consistent with this long term objective through adoption of a code of conduct for plurilaterals; conducting a Multilateral Impact Statement on all proposed and negotiated plurilateral agreements; and proactively identifying as a result of its own analysis and then proposing for negotiation specific best-practice features of RTAs and plurilaterals

that are ripe for broader integration, whether through adoption by other RTAs or a global plurilateral or even meta-RTA agreement.

By embracing and adapting itself in these ways to a world of variable geometry, the WTO could help to steer the evolution of trade and investment liberalization, most of which occurs outside the WTO, in a direction that ultimately strengthens the global trading system's legitimacy. A more creative and assertive WTO along these lines is what could make the difference between a world of competing, trade-diverting blocs in which many developing countries fall further behind, and one in which the essential MFN nature of the system is rejuvenated and a virtuous circle of balanced integration across advanced and developing countries leads to a mutually-reinforcing cycle of broad-based progress in living standards within them.

**The trade policy community and WTO would do well to learn from the recent experience of their climate change counterparts.** It took the failure of negotiations in Copenhagen in 2009 for the UNFCCC to recognize that a near-exclusive focus on its own formal normative machinery was handicapping its effectiveness as an agent of progress. The negotiations in Paris in 2015 succeeded because the organization and key constituent governments embraced a wider, variable geometry of opportunities for progress –formal and informal, public and private—and steered them toward an integrated contribution. While the results were only partial, they were significant. And they created a blueprint for the construction of future, additional progress.

The agenda outlined above, derived through an extensive process of multistakeholder deliberation, is an analogous blueprint for adapting the WTO and the global trade and investment system to changed circumstances. By embracing the wider trade and investment cooperative ecosystem, assuming a broader role for enabling balanced progress within it, the WTO has a similar opportunity during its forthcoming “period of reflection” to develop a long-term plan to restore its relevance and safeguard the system's legitimacy. The international community is counting on it to succeed.

## Introduction

The World Trade Organization (WTO) has struggled over the past 14 years to reach agreement on the Doha Round of multilateral trade negotiations. At the recent Nairobi ministerial, the organization's 162 members reconciled themselves to this reality and effectively suspended work on the overall package in its current configuration even as they reached important agreements on a few specific topics such as agricultural export subsidies.

The Round's difficulties over this period have prompted considerable soul searching about the WTO and multilateral trading system among trade policy-makers and experts. The organization itself commissioned two panels of eminent persons during the past decade. The first was a Consultative Board chaired by former WTO Director-General Peter Sutherland. Its 2004 report entitled "The Future of the WTO"<sup>1</sup> assessed the functioning of the WTO as an institution. The second was a Panel on Defining the Future of Trade<sup>2</sup> convened by then-Director-General Pascal Lamy. It issued a report in 2013 analysing the changing nature of trade in goods and services. By design, neither exercise focused on the policy agenda *per se* in deference to the ongoing negotiating process.

The failure to agree on the continuation of the Round in its current configuration has left the international community without a shared agenda for the future evolution of the global trading system. To be certain, there is no lack of initiative and innovation within the system. Regional and bilateral activity have never been more robust. But there is palpable unease about this lack of a common strategic vision and project, as well as questions about where the current dynamic of "competitive liberalization"<sup>3</sup> will lead, even among its main drivers. Such questions include:

- Will the system fragment and degrade into trade-diverting regional blocs?
- Will global trade expansion continue its disappointing recent pattern of lagging global economic growth, rather than leading and propelling it?
- Will the system be able to contribute to rather than complicate progress on other global priorities, such as climate change, sustainable development, inequality, employment, population ageing, depletion of fish stocks and biodiversity, corruption and money laundering, etc.?
- Will it be able to contain the recent proliferation of non-tariff barriers, which can be just as big an obstacle to trade as the tariffs that successive multilateral rounds of negotiations have done so much to reduce?
- Will trade-related rules be able to adapt to the technological changes transforming the operating context of businesses and the very nature of commerce and investment?

- As globalization deepens, will the system succeed in striking the right balance between the policy-making prerogatives of national and local governments, on the one hand, and the logic of international economic integration and cooperation, on the other, particularly when key social values are implicated?
- In sum, will the trading system be able to maintain its essential *positive sum game* character, both in economic fact and political perception?

These questions and others have taken on heightened importance in the aftermath of Nairobi, but they have been building up within the system for some time. It is for this reason that the International Centre for Trade and Sustainable Development and the World Economic Forum have organized the E15 Initiative, a long-term multistakeholder strategic review of international trade and investment rules and arrangements. Unprecedented in substantive scope and regional and stakeholder engagement, the Initiative convened 15 Expert Groups and three cross-cutting Task Forces, posing the question: how should trade- and investment-related rules and institutional arrangements evolve in their particular areas over the next 10 years to 2025? The Groups and Task Forces were asked to conceive of the global trade system broadly, including but by no means restricted to the WTO or other formal trade institutions. They were asked to think structurally, not incrementally, and not be bound by current calculations of political feasibility. Finally, they were instructed to be specific – to make concrete proposals and to prioritize them.

This was drafted by the two convening institutions. It synthesizes and interprets the significance of the proposals made by the 15 Expert Groups and three Task Forces, drawing directly from the policy option papers assembled by each group as well as many of the over 150 underlying research papers or “think pieces” authored by individual Expert Group members. The synthesis report and 16 chapters of policy proposals are published as a single volume, and readers of the former are encouraged to delve more deeply into the latter for further detail. The think pieces, which are a remarkably rich resource in themselves, have been published separately as they became available over the past three years and can be found on the E15 website: [www.e15initiative.org](http://www.e15initiative.org).

The Expert Group chapters were authored by a member of each respective Group, who sought to capture the main elements of their Group’s deliberations and proposals. Not all of the ideas and observations expressed therein necessarily represent those of every Group member or their institutions. The same applies to the monograph.

## Constructing A New Agenda To Strengthen The Global Trading System

The international community's last common trade agenda, the Doha Round, was largely conceived in the late 1990s. Its elements consisted mainly of the unfinished business of the Uruguay Round's 1994 Marrakech Agreement. The Uruguay Round itself was conceived in the early to mid-1980s. Thus, it has been decades since the international community last constructed a shared trade agenda from the ground up. During the intervening period, profound changes have taken place in the global economic and political context. As a result, the world is now facing a substantially different set of long-term policy imperatives than those it confronted in the 1980s and 1990s.

### Shifts in the World Economy

- **Global economic growth is markedly slower.** Annual global economic growth averaged in excess of 5% in the 1980s and 1990s, and trade was growing even faster, by an average of 6%. Today, in the continuing aftermath of the 2008-2009 global financial crisis, growth has fallen to 3%, and growth in trade flows has slowed.
- **The pattern of trade flows has diversified.** In the 1990s, developed countries accounted for 80%<sup>4</sup> of global merchandise trade and 88%<sup>5</sup> of global growth. Today, developing countries account for 44%<sup>6</sup> and 64%<sup>7</sup> of trade and output expansion, respectively. China's extraordinary economic transformation accounts for much of this shift; however, many other developing countries are also part of the story.
- **There has been a dramatic increase in foreign direct investment.** FDI in the last 10 years has been double the level of the late 1990s and three to four times higher than in the 1980s. The bulk of global trade now occurs in global or regional value chains in which goods are imported and exported at different stages of production across multiple borders (sometimes multiple times across the same border) often between related parties. These complex supply chains typically rely heavily on inputs of services (e.g. engineering, design, servicing, logistics, marketing), contributing to the growing importance of services in world trade.

### Shifts in the Political Economy of Trade

- **Political influence in the shaping of trade agendas and decisions has become less concentrated and more complex as the weight of developing countries in the world economy has increased.** The Quad countries (the United States, European Union, Japan and Canada) no longer exert the decisive influence they did up to and including the Uruguay Round. Now the crucial balancing of interests is between developed and developing countries, and sometimes among different groups of developing countries.

- **Least developed countries and smaller states have lost a measure of confidence in the universality of the system's benefits**, feeling that their interests were subordinated to those of wealthier countries in the Uruguay Round and never adequately addressed in the Doha Round. In addition, many of them have been left further behind by rapid growth and technological progress in other parts of the world economy.
- **Political energy in international economic cooperation is increasingly focused on finding ways to reinvigorate global economic growth and accelerate sustainable development in poor countries.** Unless the global trade agenda demonstrably contributes to these imperatives, it will be seen as irrelevant. This was likely a major factor in the failure of the Doha negotiations.
- **A top new priority for international economic cooperation is combating climate change.** With the new framework agreed at the recent COP21 United Nations Paris conference, attention is turning rapidly to implementation. States are accelerating efforts of various sorts, some of which – like emissions trading systems and clean energy subsidies – will have cross-border effects. Here, too, the trade agenda faces a test of relevance and coherence.
- **The business community, traditionally a principal demandeur of global trade negotiations, is increasingly focused on a new agenda**, namely factors that influence the enabling environment for investment in and operations of global value chains. Much of this agenda concerns behind-the-border rules, institutions and infrastructure that influence costs at least as much as border measures. As a result, the political energy of this important constituency is increasingly invested in regional and bilateral initiatives involving limited groups of countries that are predisposed to work on these issues.
- **Indeed, 20 additional years of accumulated evidence about what works in economic development has underscored the importance of the institutional enabling environment for private sector development.** East Asia's remarkable success story has provided a powerful example in this regard, implying that trade and institutional capacity-building assistance should be much more deeply and even explicitly linked in order for trade liberalization to fully bear fruit in – and be politically relevant to – poor countries.

The combined result of these changes is an increasingly fragmented and sometimes trade-diverting system that has moved off centre stage of international economic cooperation and is losing legitimacy and relevance for key constituencies. A new common agenda is required that can reset the trajectory of the system's evolution in ways that equip it to respond directly and tangibly to the concerns that are top of mind in Cabinets, boardrooms and kitchen tables around the world in *this* century as opposed to the latter half of the last one.

The output of the E15 Initiative is encouraging in this respect. The proposals generated by the Initiative's Expert Groups and Task Forces demonstrate that an agenda to strengthen and update the global trading system is not only conceivable but also plausible. As synthesized and interpreted in the following chapters, they form a blueprint for how the international community could come together to confront each of the following nine contemporary policy imperatives through better deployment of trade and investment rules and arrangements:

*Boosting Global Growth and Employment*

*Reducing Commercial Friction and Investment Uncertainty*

*Accelerating Sustainable Development in Least Developed Countries*

*Increasing Economic Diversification and Competitiveness in Middle-income Countries*

*Ensuring Food Security*

*Combating Climate Change and Environmental Degradation*

*Preserving National Policy Space to Make Societal Choices*

*Strengthening the Legitimacy of the Global Trading System*

There are important, possibly even transformational, benefits in this agenda for every conceivable region and constituency. Just because the world was not able to agree to the particular multilateral agenda on the table in the Doha Round does not mean that a common (as opposed to single) undertaking that leaves everyone better off is not possible.

But the path toward deeper and more effective international trade and investment cooperation in the 21<sup>st</sup> century only comes into view if one steps back from a specific focus on the WTO and appreciates the much wider ecosystem of influences on trade and investment behaviour. The proposals summarized below take such a genuinely systemic view, spanning a wide range of disciplines and institutions in a way that contrasts with most trade policy analyses, including the two formal reviews commissioned earlier by the WTO. Embracing a broader frame of reference and deploying a much wider array of tools available for international economic cooperation is fundamentally what will make a *positive sum game* outcome possible in the current, more complex, economic and political context.

This insight has important implications for national and international governance. The agendas set for trade ministers and institution need to be embedded in larger strategies set by higher authorities that integrate other policy and stakeholder dimensions. This will be the focus of the next phase of the E15 Initiative -- a dialogue around the world about the implications of this blueprint for how trade strategy is set and administered in countries and at the global level -- and how improvements in international cooperative architecture could help.



## Boosting Global Growth and Employment

Global economic growth is decelerating. The Organisation for Economic Co-operation and Development (OECD) is projecting that the world economy will have grown in 2015 at a rate of less than 3%, a level sometimes associated with a global “growth recession.” Expansion of world trade has decelerated even more markedly, to an annual rate of 2%. There have only been five years since World War II when trade has grown at such a slow pace, and this level has often been associated with economic recession.<sup>8</sup>

This weak performance is not a one-year aberration. World trade growth averaged just 2.4% between 2012 and 2014, the slowest rate on record for a three-year period when trade was expanding (excluding years like 1975 and 2009 when world trade actually declined).<sup>9</sup>

Weak global economic and trade growth are aggravating an already severe global employment crisis. The International Labour Organization (ILO) estimates that over 200 million people are unemployed and 1.44 billion people are in vulnerable employment. Both numbers are projected to worsen over the next several years. Long-run trends in labour force participation also point to a decline, and wage growth has been subdued, contributing to a long-term decline in the labour share of income.<sup>10</sup> Youth and women continue to be disproportionately affected across all regions of the world, with a youth unemployment rate that is nearly three times higher than for the adult population as a whole.

For most of the past 70 years, international trade and investment have played an important role in driving global economic growth, expanding annually at about 160% of the rate of output growth on average. This correlation held up in the post-war period from 1950 to 1973, as well as from 1974 to 2007, and even during the first period of rapid globalization from 1850 to 1914.<sup>11</sup> The recent reversal of this relationship is cause for concern.

The relative dynamism of world trade in the latter part of the 20th century and early years of this century was due in part to successive waves of trade and investment liberalization. During this period, the international community completed no fewer than eight multilateral rounds of trade negotiations and countless bilateral and regional arrangements. Between 1950 and 2007, world merchandise trade expanded at an average annual rate of 6.2%,<sup>12</sup> three times the current rate, and the world economy grew over the same period at an average rate of 3.8%.

**Were the world economy able to return to its historical pattern of trade and output growth, the global growth rate could be nearly a full percentage point above currently forecasted levels,** which would have major positive implications on employment in countries around the world. What improvements in trade rules and institutions have particular potential to boost growth and employment and thereby shift the world economy back onto its long-term trajectory?

Economic growth per capita is generally understood to be a function of the quantity and quality or productivity of factor inputs, such as capital and labour, and the pace of technical progress in particular. Most economists believe that technological progress accounts for most of an economy's growth performance over time, 80% in the case of a famous estimate of the United States' long-term rise in per capita income.<sup>12a</sup>

International trade and investment contribute to growth by facilitating the flow of capital, labour and technology to their most productive uses across the world economy. By expanding competition and diffusing technology and know-how, they help countries to concentrate and more fully capitalize on their actual or latent comparative advantages, thereby boosting output per capita. This heightened exposure to competition often has a positive secondary effect on growth by motivating countries to strengthen domestic institutions and undertake structural reforms that further enhance economic efficiency and productivity growth.

Three sets of proposals developed by E15 Expert Groups<sup>2</sup> have particularly strong potential to boost global growth and employment over the next 10 years by:

- Increasing the diffusion of productivity-enhancing technologies across the world economy;
- Improving the allocation of the capital and skills to their most productive potential applications;
- Expanding trade and investment in employment-intensive industries.

### Diffusing Technological Progress

Digitization is a principal source of technological progress in the world today. As summarized in the E15 Services and Digital Economy Expert Group chapters of this volume, the digital revolution has reduced transactions costs in a variety of ways, raised productivity and contributed strongly to growth. It is a key driver of innovation and has brought about new products and new ways of producing and consuming old ones. It has reshaped business models and injected an unprecedented level of inclusiveness into commerce. The smallest enterprises can today aspire to serve markets worldwide. At the same time, large multinational firms have also relied increasingly on the internet to do business, coordinate physically disperse operations and exchange information.<sup>13</sup>

Following is some of the evidence that has emerged in recent years about the digital economy's contribution to economic growth and employment:

- Productivity growth. Much of the strong productivity growth in the United States in the mid-1990s through to the mid-2000s has been attributed to strong investment in information and communication technologies.<sup>14</sup> A recent study of EU firms also found that engaging in e-commerce increases labour productivity – and that e-commerce accounted for 17% of EU labour productivity growth between 2003 and 2010.<sup>15</sup> A 2014 US International Trade Commission (ITC) calculated the productivity gains from the internet by surveying US businesses and converting the results into an economic model. The ITC found that the productivity gains from the internet have increased US real GDP by 3.4-4.5%.<sup>16</sup>
- Small and medium-sized business expansion. In a survey of the internet's use in 12 advanced and developing countries, McKinsey Global Institute found similar microeconomic evidence, in particular a significant increase in performance in businesses at all levels and particularly among small and medium-sized enterprises (SMEs) and other entrepreneurial endeavours. Of the more than 4,800 SMEs surveyed, those utilizing Web technologies grew more than twice as fast as those with a minimal presence. The results hold across all sectors of the economy. Further, Web-savvy SMEs brought in more than twice as much revenue through exports as a percentage of total sales than those that used the internet sparingly. These Web-knowledgeable enterprises also created more than twice the jobs as companies that are not heavy users of the internet.<sup>17</sup>
- Job creation. McKinsey also found that digitization in general and the internet in particular contribute importantly to job creation. A detailed analysis of France over 15 years showed that the internet created 1.2 million jobs and destroyed 500,000, creating a net 700,000 jobs or 2.4 jobs for every one destroyed. This result is also reflected in the survey of SMEs across the 12 countries, which shows that 2.6 jobs were created for every one destroyed, confirming the internet's capacity for creating jobs across all sectors.<sup>18</sup>
- Exports. eBay has found that 95% of SMEs in the United States using its platform to sell goods and services are engaged in export to customers in more than four continents – compared with less than 5% of US businesses that export offline. In addition, 74% of these SMEs are still exporting after three years, compared with 15% of offline exporters.<sup>19</sup> Similarly, a survey of businesses in developing countries using the eBay platform found that over 95% of SMEs were engaged in export, and that 60-80% of these businesses survived their first year, compared to only 30-50% for offline exporters.<sup>20</sup>

Thus, one of the most important ways the trade and investment regime could contribute to higher economic growth and employment over the next 10 years would be to reduce existing or prevent the imposition of new barriers to the wider diffusion of digital technology and exchange of goods and services it supports via the internet. Following is a specific agenda for this purpose developed by the E15 Digital Economy, Services and Innovation Expert Groups:

**Unilateral (National) and Plurilateral Action**

**Scale internet-enabled SME trade.** Digital trade is changing the composition of goods trade. Pre-internet, it was often not commercially viable to export low value goods. As a result, international trade has been dominated by large companies exporting goods in bulk. The development of internet platforms that have connected businesses and consumers globally has opened up new opportunities for trade often by SMEs in individual goods of relatively low value. This includes SMEs in developing countries, which are increasingly leveraging the internet to export around the world.<sup>21</sup> The growth opportunity this represents is reflected in data showing that the global delivery of small packets, parcels and packages increased by 48% between 2011 and 2014. Following are proposals that countries can take unilaterally or in groups to take fuller advantage of the opportunities for SME growth created by digitization:

- Adopt interoperable, digitally-enabled **single windows for customs and border compliance**, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows. Aid for Trade capacity-building assistance should be expanded to help finance the implementation of these steps by developing countries;
- Create comprehensive, **online, single points of enquiry** for cross-border services providers to learn about host country **regulatory, licensing** and other administrative requirements;
- Establish higher, standardized *de minimis* **customs levels** to facilitate cross-border flows of small packages supplied by internet-enabled retail services providers, especially SMEs. These levels currently range from less than \$1 to \$1,000. Requiring businesses to make customs declarations for goods of small value creates additional transaction costs.<sup>22</sup> According to one study, a 10% increase in time to move goods across borders reduces exports of time-sensitive manufacturing goods by more than 4%.<sup>23</sup> For trade in lower value goods that the internet is enabling, such costs account for a relatively larger share of the goods' total value, making it an even more serious trade barrier. Moreover, it is the consumer that is responsible for completing customs forms and paying the duties, adding another barrier to digital trade. Returning goods are also often treated as imports, which means they are again subject to similar documentation requirements and customs duties. In 2011, 10 Asia-Pacific Economic Cooperation (APEC) members agreed to implement a *de minimis*

value of at least \$100, which was estimated to produce a cost savings of \$19.8 billion per year in the APEC region.<sup>24</sup> Developing countries should adopt this or possibly \$200 as a minimum common threshold, with more advanced countries adopting a higher common threshold, such as \$800;<sup>24a</sup>

- Explore the integration of national postal services into an **interoperable, global, package-shipping network**.

**Establish clear rules pertaining to the electronic transmission of data and related services.** Global and regional supply chains are a principal means by which technology and know-how are diffused around the world. Accounting for an increasingly important proportion of world trade<sup>24b</sup>, they require extensive, real-time communication and coordination among a complex chain of design, production, transportation and marketing functions. This constant communication and just-in-time, precision management of resources are critically dependent upon the free flow of data across borders. The international coordination of rules pertaining to data transfers and regulatory issues raised by the new forms of commerce they support remains at an early stage. Following is a set of measures that countries could take unilaterally or in groups to establish a conducive enabling environment for this increasingly important dimension of the world economy:

- Allow the **free flow of data across borders** subject to an exceptions provision based on the General Agreement on Trade in Services (GATS) Article XIV concerning the right of countries to protect the privacy of personal data as long as such right is not used to circumvent the provisions of the agreement. The World Trade Organization (WTO) has such a data flow commitment but it only covers the financial sector, whereas the US-Korea Free Trade Agreement (KORUS) is an example of two countries agreeing to take a broader approach. Such a step should be accompanied by an explicit commitment to **eschew data localization requirements**, such as that included in the recent Trans-Pacific Partnership (TPP) agreement;
- Establish regulatory certainty and coherence by **aligning rules with leading practices regarding intermediary liability, privacy, intellectual property, consumer protection, electronic signature and dispute settlement**. Examples of leading practices on which to build include the 2005 APEC Privacy Framework and anticipated revised EU privacy Safe Harbour; 2007 OECD Recommendation on Consumer Dispute Resolution and Redress; new TPP commitments requiring parties to achieve an appropriate balance in their copyright systems through limitations and exceptions pertaining, for example, to fair use; KORUS provisions requiring consumer protection agencies in the two countries to cooperate in the enforcement of each other's laws against fraudulent and deceptive practices; and the KORUS commitment not to prevent parties to an electronic transaction from determining their own authentication methods;

- Establish a **permanent moratorium on the imposition of customs duties on the electronic transmission** of products. The agenda for the WTO Nairobi ministerial is still being finalized, and a further extension of this moratorium is likely to be agreed there. However, a permanent moratorium should be the aim as it would increase certainty among businesses and further support digital trade. This is increasingly necessary as more and more products (such as films, books and music) are traded across borders virtually rather than physically, in some cases creating uncertainty about their proper tariff classification.

**Initiate negotiations to establish a Plurilateral Digital Trade Agreement or “eWTO”.**<sup>24c</sup> A forward looking group of countries from various regions should take the initiative to create an **agreement to implement a comprehensive set of policies and leading regulatory and multistakeholder practices such as those outlined above**, to maximize the growth and employment potential of internet-enabled trade. If such a group included, among other countries, the United States, China and European Union, its provisions could be extended on a most-favoured-nation basis to all countries as a “critical mass” agreement under WTO rules, thereby benefiting from access to WTO dispute settlement procedures. Such a plurilateral initiative would be a powerful stimulus to global growth and employment, particularly in the SME sector around the world.

### **Multilateral Action**

These national and plurilateral actions could be reinforced by a number of steps in the WTO, including:

**Expand the Information Technology Agreement (ITA2).** An existing plurilateral, critical mass agreement known as the Information Technology Agreement (ITA) eliminated tariffs on certain information technology products based on an accord reached in 1996. To date 81 countries have joined the agreement, accounting for 97% of worldwide trade in the products it covers. Negotiations to expand the coverage of the agreement by 201 additional products (ITA2) were completed at the WTO’s 10th ministerial meeting in Nairobi in late 2015. Annual trade in these 201 products is valued at over \$1.3 trillion per year, and accounts for approximately 7% of total global trade today.<sup>25</sup>

**Create a WTO Working Group on Digital Trade.** WTO rules in a number of areas already provide a strong foundation in support of the digital economy and digital trade.<sup>26</sup> Several cases that have gone through dispute settlement have addressed selective digital trade issues. Looking ahead, rather than wait for cases to arise that raise selective issues, a WTO working group could be composed to examine how the needs of digital trade are now covered under the existing rule framework, identify areas where coverage is inadequate or ambiguous, and recommend appropriate clarifications or adjustments. A technical advisory committee of private sector and academic experts should be organized to support the working group.

Among the items it should consider are:

- *GATS clarifications.* As noted above, the convergence in basic and value added telecommunications services makes unclear the scope of WTO Members' GATS commitments.
- *WTO Telecoms Reference Paper clarifications.* That Paper includes pro-competitive regulatory principles for the telecommunications sector which are designed to ensure that former monopoly operators do not use their market power – such as control of access to telecoms infrastructure – to undermine competitive opportunities for new market entrants.<sup>27</sup> It has been an important tool underpinning the move towards greater competition in the telecommunications sector but by its very terms is not fully self-explanatory, especially with respect to the internet.
- *Recommendations to provide direction to the Work Programme on Electronic Commerce* in the event that process does not yield progress at the Nairobi ministerial meeting.
- *Recommendations for the creation of a Trade Policy Review Mechanism (TPRM) framework* for the analysis and benchmarking of the consistency of country measures affecting digital trade with their WTO commitments.

**Include research services in GATS.** More broadly, research and development (R&D) services ranging from equipment purchases and testing protocols to grant management and accounting and beyond are often heavily regulated in favour of domestic providers. Compliance regulations may raise duplication costs and inefficiencies and encounter significant resistance if those regulations are subject either to technical barriers to trade disciplines or harmonization. A meaningful alternative would be to bring research services into GATS negotiations for those countries willing to liberalize the sector in particular ways. Commitments to open such services to competition, whether through GATS or perhaps the emerging Trade in Services Agreement (TISA), could offer efficiency gains and improve network linkages, increasing the worldwide pace of technical progress.<sup>28</sup>

**Establish an Agreement on Access to Basic Science and Technology.** The E15 Expert Group on Innovation has endorsed a more far-reaching proposal to create a WTO Agreement on Access to Basic Science and Technology (ABST) aimed at strengthening the global commons in science and technology without unduly restricting private rights in commercial technologies.<sup>29</sup> The mechanism, which could be initially undertaken as a plurilateral agreement, would be to place into access pools the patented results of publicly funded research that develops knowledge capable of supporting applied science and R&D, especially in areas of common global concern, such as climate change and medicines. In essence, funding agencies in the participating nations would certify that, as a condition for receiving a grant in specific areas of primary science, universities and scientists must agree

to place the resulting patents in common resource pools. These patents would then be available for license to all competent agents from other member countries under terms worked out in advance.

### Improving The Global Efficiency of Capital and Labour

If the goal is to boost global growth and employment – to achieve a systemic acceleration of economic growth and job creation – then distortions in the flow of capital and workers to their most productive applications worldwide, in particular between developed and developing countries, merit special attention. Two distortions particularly stand out:

- The low level, concentrated and variable nature of capital investment flowing from comparatively low-growth advanced countries to more rapidly growing developing countries;
- The even lower level of engagement of underemployed workers in developing countries by advanced countries whose population ageing and low fertility are projected to create labour shortages that are projected to slow or could even reverse the expansion of their economies in the near future.

**Capital allocation.** If more private capital in both rich and poor countries flowed to high-return investment opportunities in emerging and developing countries, away from their current concentration in comparatively low-yielding government debt and other assets in advanced countries, then incomes and aggregate demand would increase in both places, other things being equal. Much of the solution to this suboptimal global allocation of capital lies in domains other than trade policy (e.g. strengthened investment climate and regulatory institutions in poor countries and changes in the time horizons and fiduciary practices of investors in wealthy countries). But the E15 Expert Group on Finance and Development identified the following improvements in trade and trade-related arrangements that could make a major difference:

**Ensure correspondent-banking availability.** Banks have sharply cut down on their correspondent-banking networks as the costs of regulatory checks, such as Know Your Customer (KYC) activities, have far outpaced the growth of business potential. Further issues, centred on anti-money laundering actions, have reinforced this trend. Though hard data concerning this issue is scarce, it is believed in the banking community that the sharpest cuts were made in low-income countries, to the point that some of these countries are on the verge of being excluded from international financial networks. The consequence of this financial exclusion is particularly serious when it comes to the exchange of goods and services since, without the ability to exchange information or funds, local companies struggle to enter into the contractual obligations that underpin international trade. The economic development of many low-income countries is therefore severely compromised. The Expert Group's proposal is that each country should house at

least one local bank with a fully-fledged correspondent-banking arrangement with international financial institutions. The key steps involved in bringing this proposal to fruition are:

- Sponsoring/mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group<sup>29a</sup> the process leading to the improvement of the local correspondent bank(s)'s governance structure;
- Validating the KYC process by the sponsor so that it will be deemed to be sufficient for international regulatory purposes; and
- Securing an international ruling to ensure that developed country banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s).

**Deepen regional regulatory cooperation in financial services.** The integration of financial services has received insufficient attention in regional integration efforts. Slow progress in the area of financial integration has made it difficult for banks and other financial entities to operate regionally and support their customers so that they can enjoy the benefits of diversified, more efficient and cheaper financial services. It is important to ensure that the full extent of benefits arising from the economies of scale accrue to those in need of finance, such as micro, small and medium enterprises (MSMEs). Access to finance has been highlighted as the single most important constraint for MSMEs to face the competition of an integrated regional market and connect with the global economy. Key issues to be addressed include the heterogeneity of regulatory frameworks and restrictive market access, significant checks on the mobility of talent, and constraints on cross-border data flows and offshoring regulatory structures. Three concrete steps can be implemented in various regional fora:

- The creation of regional mechanisms, such as regional credit bureaus and rating agencies;
- The facilitation of free data flows and offshoring;
- The standardization of documents and documentation requirements.

**Strengthen international frameworks supporting long-term foreign direct investment in developing countries.** The international trade and investment regime could very substantially improve its support for foreign direct investment (FDI) in developing countries by implementing:

- The slate of investment policy reforms recommended by the Expert Task Force on Investment Policy and summarized in monograph chapter 3, pp. 4-5);
- The slate of global value chain proposals made by the E15 Expert Group on Global Value Chains and summarized in monograph chapter 2, pp. –3-4, in particular a Global Value Chain Development Platform;

- New public-private international financial architecture<sup>29b</sup> aimed at pooling risk mitigation, technical assistance, and debt and equity financing of interested bilateral and multilateral development banks, banks and institutional investors from both developed and developing countries, matching their investment processes to unlock private investment at scale in sustainable infrastructure and industry in developing countries.

*Labour allocation.* Economic migration is one of the most socially and politically sensitive topics facing many governments. But the economic growth dimension of this issue is too often overlooked. Several major economies – Japan, Germany, South Korea, Italy and Russia to name a few – are facing an outright contraction of their labour forces in the decades to come. Finding ways to import or otherwise integrate other sources of labour is one of their most important economic policy imperatives. How well they succeed in doing so will have far-reaching ramifications for the growth and employment trajectory of not only their own economies but also the world economy as a whole.

The temporary presence of non-residents who enter foreign markets to supply services has grown in importance with the internationalization of production. Global value chains require a continuing stream of people across frontiers to enable flows of goods, services and knowledge. The growing importance of digitized commerce that requires elements of expertise from non-resident suppliers of services also argues for improvements in temporary presence regimes. The bundling of goods and services to create value has increased complementarities and strengthened the case for an integrated “Mode 4 approach” that also encompasses manufacturing activities. The need for a larger bargain on Mode 4 trade is also rooted in underlying global demographics and chronic skills shortages in a number of sectors.

The E15 Expert Groups on Services and Innovation have made two proposals related to the migration of skilled technical personnel important for research and development, on the one hand, and the functioning of cross-border value chains, on the other.

### **Streamline processes and procedures related to visas and work permits.**

Opportunities exist for reaping greater benefits from trade involving the temporary movement of natural persons across frontiers to provide services. Realizing these benefits does not require any modification to nationally determined public policy priorities with respect to such activities. Rather they rely on greater legal clarity and procedural efficiency, combined with closer regulatory cooperation among governments. Specifically:

- Calling upon WTO members to clarify GATS provisions in relation to how the Agreement covers processes and procedures related to visas and work permits;
- Improving transparency in relation to national conditions, procedures and processes for issuing visas and work permits;
- Strengthening regulatory cooperation between governments for managing the entry and stay of natural persons for the supply of services.

- **Establish a plurilateral but open “innovation zone”** working through GATS within which skilled researchers and technical personnel would be able to migrate freely for up to 10 years. Information, knowledge and know-how are usually transmitted by people; therefore, the Innovation Expert Group considers that increasing the ability of knowledge workers to move across international borders with maximum ease and without being tied to any particular employer for a temporary yet sufficiently long period of time – perhaps for a period of up to 10 years – is a longer-term policy option worth exploring.<sup>30</sup> This expansion in the international mobility of skilled and research-oriented persons would raise the probability of shared knowledge and thus of increased innovation and creativity worldwide. This would likely start as a plurilateral agreement, but would be open to all countries – whether developed, emerging or least-developed – and could build on Mode 4 of the GATS.<sup>30a</sup>

### Expanding Trade and Investment in Employment-Intensive Industries

The impact of the services sector on the process of economic development is relatively neglected, despite the evident and tremendous contribution of the services sector to national and global GDP, employment and value-added measures of international trade. There was a time when the dominant assumption in the development literature, reflected in policy and practice, was that services were low productivity, low value-added and largely non-tradable. These assumptions are not consistent with the conceptual framework on the modes of delivery established in the WTO’s GATS. Nor are they borne out by the recent empirical work on the role of services in innovation, multifactor productivity and trade in value-added. The important WTO work in reaching the Trade Facilitation Agreement has focused on reducing the costs of trade in goods. Attention now needs to turn towards reducing the costs of trade in services.

To this end, the E15 Expert Group on Finance and Development and the Expert Group on Services have proposed:

**Development of a comprehensive WTO Framework for Trade Facilitation in Services**, with attendant measurable indicators as in the Trade Facilitation Agreement. This Framework should encompass both cooperative and negotiating mechanisms, complemented by capacity building and technical assistance, through which the multilateral trading system can spur concerted action. It should include mechanisms for public-private dialogue with services stakeholders and allow for and encourage implementation of measures on a regional, plurilateral and multilateral basis. The Framework should address inter alia:

- Intensified temporary and short stay visa facilitation;
- Enhanced access to finance for trade in services;
- Common guidelines for the governance of electronic trade and cross-border data flows;

- The benchmarking of best practices and development of regulatory principles to address cross-border market failures in services sectors.

## Conclusion

Over the years, trade and investment have been important contributors to innovation, growth and employment in the world economy. E15 Expert Groups have proposed an extensive and specific action agenda of measures that can strengthen that contribution at precisely the time the world is searching for new engines of growth. By increasing the diffusion of technology, more efficiently connecting capital and labour with their most productive uses and expanding opportunity in the employment-intensive services sector, these measures deserve to be a central element of international economic cooperation over the next several years. Many of them can be implemented in short order by acts of governments or self-associating coalitions thereof, rendering this agenda actionable even in the absence of the kind of grand multilateral undertaking that typically takes a decade or more to assemble. They demonstrate the central relevance of trade and investment policy to global economic progress.

## Reducing Commercial Friction and Investment Uncertainty

International trade and investment activity result from a great quantity of individual commercial decisions taken by business people and investors around the world, in companies large and small. These decisions are influenced by prevailing national and international policies and legal frameworks but also by future expectations, economic conditions, available technology and resources, established business models and many other factors.

To many business people, trade policy appears part of the landscape; they work with or around it but don't spend much time thinking about or trying to change it. To the extent that salesmen, purchasers or, in large companies, deeply experienced supply chain officers or other executives express opinions on what they'd like from trade policy, they often start with a set of broad requests:

- 1) However good a policy is on paper, it is of little use unless it is **properly implemented**.
- 2) Policy needs to be **simple** so business can comply with or take advantage of it with the least hassle possible. In the first instance, this entails making the rules clear and easily available. Policies that increase the visibility of rules, and even better, market information, from other markets, are seen as valuable.
- 3) Where possible, policies that establish **coherence between different jurisdictions**, allowing businesses to offer their products and services in the most replicable or modular fashion as possible, are encouraged. Businesses often operate in a fast-paced competitive environment, so speed and pragmatism in setting up new arrangements or resolving disputes are called for.
- 4) Businesses also value **certainty** in critical policy areas, like climate change mitigation, that affect their long-term strategy. This allows them to plan their R&D, product design, sourcing and production.
- 5) Businesses recognize that developing countries often do not have the means to rapidly implement reforms, so **capacity-building** interventions are applauded.
- 6) Since strict demarcations between investment and trade, goods and services create frictions and distortions in the operation of global value chains, a **systems approach** is preferred.

This last point is particularly important to understanding business requirements for the evolution of the international trading system over the next 10 years, the perspective taken by the E15 Initiative. More and more of the world's economic activity is now organized through global value chains (GVCs) and strategic networks, rather than through arm's length sales between vertically integrated buyers and sellers in different countries, as the textbook examples of international trade imply. The most obvious evidence of that trend lies in the percentage of world trade made up of intermediate goods – *a nearly 60% share of world imports<sup>31</sup> and close to three-fourths of the imports of large developing economies, such as China and Brazil.*<sup>32,33</sup>

But, as explored in depth by the E15 Expert Group on Global Value Chains<sup>34</sup> and summarized below, the impact of GVCs extends well beyond the higher volume of trade in intermediates. Global value chains draw “a broader range of establishments, firms, workers, and countries into increasingly complex and dynamic divisions of labor”,<sup>35</sup> which has driven a much deeper and more far-reaching change in the organization of production globally and the basis of competition).<sup>36,37</sup> Services are playing a key role in the operation of these GVCs and international production networks, especially transport, communications and other business services, the fastest-growing component of world trade. Goods and services are now fully intertwined and inseparable in production, and investment decisions are pushing international trade flows and patterns.<sup>38</sup>

Linkages in a value chain consist of “more than just the purchase of raw materials and standardized intermediate goods”.<sup>39</sup> It requires “finding a partner with which a firm can establish a bilateral relationship and having the partner undertake relationship-specific investments so that it becomes able to produce goods or services that fit the firm's particular needs”.<sup>40</sup> Establishing the required linkages to form a global value chain “depends inter alia on the thickness of the domestic and foreign market for input suppliers, the relative cost of searching in each market, the relative cost of customizing inputs, and the nature of the contracting environment in each country”.<sup>41,42</sup>

In that respect, participation in GVCs is fundamentally different from engaging in exchange in the textbook example of a completely undistorted market under conditions of perfect competition. In the case of arm's length sales, price is both the principal determinant of competition and the principal means of conveying information about the value the buyer and seller attach to the good or service exchanged.<sup>43</sup> Very little more needs to be shared between buyer and seller to effect a transaction, particularly if the exchange is an isolated, rather than a repeated, event. In contrast to market-based transactions, participation in a firm's supply and value chain requires a good deal more in the way of sharing information, which underscores the importance of rules and other institutional arrangements that protect that information, whether in the form of patents, copyrights, trade secrets or other institutional arrangements.<sup>44,45</sup>

Participation in value chains also requires the ability to communicate effectively up and down the chain, which requires an infrastructure that supports such communication, as well as rules that protect those communications.<sup>46</sup> Increasingly, participation in value chains also requires the ability to innovate with other links in the chain, which requires a higher level of both technological sophistication and human capital, and institutions that foster entrepreneurial innovation.<sup>47,48</sup> As a consequence, competition in this networked world is not based on price alone but depends as well on the capacity of firms and of economies to integrate themselves into the value chains that serve global consumer markets. That, as it turns out, has significant implications for how “market access” is defined in a more globalized world economy.<sup>49</sup>

In this networked world, steps aimed at increasing the quality and reliability of goods and services, decreasing time to market, and enhancing the ability to innovate matter more than lowering the price wedge that tariffs can create. Enabling local firms’ participation in GVCs requires a focus on improving both an economy’s “hardware” (for example, transportation and communications infrastructure) and its “software” (that is, its institutional arrangements, such as quality and safety standards; improvements in customs procedures, and so on). This suggests the need for a broader focus for trade policy – one informed by the need to create an environment that facilitates participation in such value chains.<sup>50</sup>

Out of the work of the E15 Expert Groups on Global Value Chains, Services, Competition Policy, Regional Trade Agreements and Digital Economy, as well as the Task Forces on Investment Policy and Regulatory Coherence, among others, has emerged such an agenda – **a 21st century specification sheet for the global trading system reflecting the realities of the new, more highly networked world economy in which international business people now operate**. This agenda consists of proposals that would have the effect of substantially reducing commercial friction and investment uncertainty, the first within existing international trade rules and arrangements and the rest through a number of specific improvements in them.

There is high potential to increase the efficiency and extend the reach of GVCs into new sectors and geographies. New forms of international cooperation could facilitate this process through deepened analysis, public-private dialogue, country-specific (unilateral) reforms and capacity building.

### Establishing a Global Value Chain Partnership

The E15 Global Value Chains Expert Group has made concrete proposals in each of these dimensions that could be combined in **a new international public-private platform to improve the efficiency and inclusiveness of global supply chains**. This platform would be aimed fundamentally at helping to increase practical cooperation between countries seeking to integrate their economies into international supply chains and the companies and experts who could be their partners. The action orientation of the partnership would be underpinned by important new analytical efforts to map existing value chains and impediments to their expansion in new geographies as well as to assemble evidence and examples of good practice that can inform countries of how to maximize the contribution to sustainable development of their participation in global and regional value chains. Specifically, the partnership would include:

Supply chain councils. The private sector plays a key role in the operation of supply chains and there is a need for governments and policy-makers to better understand exactly how supply chains operate in practice. The creation of “supply chain councils” could serve this purpose, along the lines proposed by Hoekman (2013).<sup>51</sup> These councils could focus on a selected number of specific production networks and would be composed of private sector firms, trade officials and regulators working within the sector in question. The councils would be tasked with two main areas of work:

- Carrying out mapping studies of the supply chains in specific production networks, identifying inputs used and locations from where they are sourced, as well as the “bundling” of inputs involved in the production process;
- Identifying the functioning of the GVC, its governance structure and most binding regulatory policy constraints that impact on the operation of the supply chain in question.

This initiative could help move beyond the current ad hoc and often superficial analysis of the functioning of specific value chains, while promoting a better understanding in policy circles of the constraints faced by the private sector, particularly in developing countries. The implementation of mapping studies within the supply chain councils would allow firms to lend their expertise to help policy-makers concretely understand how the fragmentation of production is taking place in practice. The results of these mapping studies could feed into discussions in various policy contexts, both internationally and domestically.

Development analysis. Given the uneven participation of countries in GVCs, the platform could host relevant policy research initiatives on GVCs, document their developmental implications, and develop and refine relevant metrics of policy analysis. Currently there is no platform gathering insights on how GVCs may offer a path to economic development and what type of developmental benefits might be gained from participating in these networks – with a view to assisting awareness and adoption of relevant strategies on the part of developing country officials. The information contained in the platform could serve the interests of developing country policy-makers with respect to the most appropriate policies to be adopted at the national and regional levels, including trade and investment policies, which would assist the insertion and upgrading of their firms into global production networks. Such information could also assist developing country officials in their participation in the negotiation and operation of regional trade agreements, as well as in the formulation of their national development strategies and the execution of their policy agendas. The information hosted by the platform could also be fed into the various regional integration processes, the deliberations of the development community, Aid for Trade strategies and donor assistance decisions. It could thus facilitate the meeting of minds and joint discussions of the trade and development communities. Online discussions and training could be organized on the platform, which would bring together analysts on the developmental aspects of GVCs and interested government officials.

Country strategies and capacity building. Countries could take advantage of the platform's resources to develop strategies for increasing their engagement in and benefits from global and regional value chains. The value chain analytics, development expertise and opportunities for interaction would create a fertile environment for governments, firms and donor agencies providing support for capacity-building requirements to explore opportunities for cooperation. Indeed, the platform could be a focal point for the development of a major new plank of Aid for Trade funding and technical assistance that is focused on helping countries strengthen the institutional aspects of their enabling environments which are crucial to the effective functioning of value chains (e.g. services, investment, regulatory frameworks, customs and logistics, etc.). In addition to these ongoing activities of the platform, an annual forum or summit could be organized to take stock of progress, engage leaders and stimulate public-private dialogue aimed at drawing wider lessons from experiences around the world and identifying new strategic priorities.

The proliferation of regional and bilateral international trade and investment agreements over the past two decades has dramatically reduced barriers and improved international business and investment conditions. However, it has also created considerable new complexity and placed under the spotlight policies that governments have traditionally considered purely domestic matters and therefore that they are only beginning to think about coordinating. Both of these factors are generating new costs and uncertainties for businesses that a number of the proposals developed by the E15 Expert Groups address.

## Rationalizing preferential trade arrangements and investment agreements

There are over 400 regional trade agreements (RTAs), twice as many as there are states in the world, and several more are under negotiation. At the same time, nearly 3,300 bilateral and plurilateral investment agreements exist. The multiplication of these arrangements in recent decades, many of them with overlapping membership but different rules of origin and other conditions, has created not only commercial complexity but also trade diversion and fragmentation. The time has come to address both aspects of this problem.

- Simplify the **conduct of business across multiple regional and preferential trade agreements** through an **RTA Exchange**. The Expert Group on Regional Trade Agreements has proposed the creation of a comprehensive open information platform to enhance understanding about RTAs and encourage a dynamic of learning, sharing of best practices and ultimately cooperation among them that can lead to the harmonization and even multilateralization of subsets of their rules.<sup>52</sup>

While RTAs are designed to lower the costs of cross-border business and paved the way for new production and distribution networks, the spaghetti bowl of multiple overlapping RTAs has created transaction costs to companies that operate global supply chains. Also small business exporters seeking to trade across many different markets, each with its own RTA, are mired in the maze of rules. Even though there are “RTA families” where different RTAs have rather similar rules (such as the US and EU’s respective trade agreements), the proliferation of RTAs has compounded the spaghetti bowl problem. Studies by the Inter-American Development Bank (IDB) and Asian Development Bank (ADB) indicate that some 60% to 80% of large companies in such diverse countries as Peru, Singapore, Thailand and Mexico would much prefer a single set of rules of origin to the several Rule of Origin (RoO) regimes in the RTAs signed by their respective governments. The complexity is also troublesome to customs officials for verifying RoO in countries with multiple agreements, such as Chile, Mexico, Singapore, Thailand, the United States and Vietnam. Erasing some of the transaction costs can yield major economic gains, particularly for smaller economies. A logical place to start would be to encourage wider acceptance of the diagonal cumulation of rules of origin, which would begin to streamline business operations across multiple RTAs.

By now, RTAs offer a vast reservoir of tested and tried rules that can help advance multilateral rule-making in critical areas. However, so far, RTA disciplines have not been multilateralized, and typically they extend only to RTA members. They are also not covered by the dispute settlement system of the World Trade Organization (WTO). Expanding the number of countries that apply rules negotiated and applied in the major RTAs would most likely yield great new efficiencies and expand world trade. Plurilateral agreements can be just the right vehicle for enabling a larger number of countries to sign onto tested and tried

sets of rules incubated in RTAs. However, it is not yet clear which plurilaterals should be negotiated or how plurilateral talks should be structured so as to enable all countries in the multilateral trading system to benefit from them.

The IDB, in collaboration with the ADB and the International Centre for Trade and Sustainable Development (ICTSD) are in the process of implementing the RTA Exchange proposal as a dynamic online platform and forum to share information, ideas, experiences and good practices on RTAs; further the capacity building of negotiators to negotiate and implement RTAs and companies to apply RTAs globally; regularly take stock of the general public's views on policies related to RTAs; survey the private sector's views on the functioning of RTAs; and further idea-generation to advance convergence and coherence with the multilateral system.

- Simplify the **conduct of business across multiple investment agreements** through a **model investment agreement**. The Expert Task Force on Investment Policy has proposed a multi-tiered set of recommendations to streamline and modernize the patchwork quilt of investment agreements around the world. The Group suggests building on the recent changes that have been incorporated in model investment agreements of countries as diverse as Norway and India, as well as the work under way and mandated by the United Nations Financing for Development conference in Addis Ababa at the United Nations Conference on Trade and Development (UNCTAD). Specifically, a consultative process would be launched to develop an updated articulation of the overall purpose of international investment agreements (IIAs). The Investment Policy Framework for Sustainable Development recently issued by UNCTAD could serve as a starting point for this process, which would seek to build common ground on not only the articulation of and set of definitions for this restatement of the purpose of IIAs but also the design of the main elements of a 21st century international model agreement, using as building blocks a few of the more recently concluded bilateral agreements and perhaps the prospective US-China bilateral investment treaty that is under negotiation. This new model framework, formulated as a best practice open for voluntary adoption, would be a bottom-up way to spur the modernization and harmonization of an international investment regime that has become highly complex and in some cases out of date. It could be coupled with an open information exchange platform such as that proposed above to stimulate the streamlining of RTAs. Or this “Investment Agreement Exchange” feature could be incorporated into that platform.

## Coordinating services, competition, data transmission, IP and other trade-related regulation

Each of these policy areas is relevant to the establishment and functioning of an operation within an international supply chain, and yet governments are only now beginning to establish international frameworks that can simplify and add certainty to the investment and operational decisions of companies. The E15 Expert Groups in these areas have developed proposals to encourage this process by identifying leading practices on which to build wider understandings among countries. These could be added separately or in combination in a modular fashion to new or existing free trade agreements. Specifically:

### Services

- **Create a network of country one-stop, online information platforms on services regulations, supported by capacity-building assistance for developing countries.** Online single windows for cross-border services providers in need of licences, permits and other administrative requirements should be established as a priority for developing countries seeking to build on their Trade Facilitation Agreement progress. The scope of Aid for Trade funding should be expanded for this purpose;
- **Facilitate the movement of skilled labour.** Processes and procedures related to visas and work permits should be streamlined through a clarification of General Agreement on Trade in Services (GATS) provisions in relation to how the Agreement covers processes and procedures related to visas and work permits as well as an initiative to establish a plurilateral but open “innovation zone” working through GATS within which skilled researchers and technical personnel would be able to migrate freely for up to 10 years. This would likely start as a plurilateral agreement, but would be open to all countries – whether developed, emerging or least-developed – and could build on Mode 4 of the General Agreement on Trade in Services;<sup>52a</sup>
- **Utilize best-endeavour clauses,** accompanied by monitoring and assistance, to create momentum in services trade agreements where hard law commitments may not be feasible in the near term;
- **Expand cross-country benchmarking.** The Organisation for Economic Co-operation and Development (OECD) Services Trade Restrictiveness Index should be continued and expanded. It is a helpful tool to set policy reform and capacity building priorities;
- **Integrate services and goods in policy.** Appreciation of the need for trade-

related policy coherence across services, goods and investment should be expanded by deepening the Trade in Value Added research of the OECD and WTO and establishing a WTO Working Group to recommend ways to reduce distortions resulting from the separate rules for goods and services. Taking account of approaches adopted in preferential trade agreements, this exercise could identify areas where the goods and services firm playing field is not level; suggest ways to bring together the rules; evaluate the resulting implications of extending multilateral disciplines on investment beyond those inherent in the GATS; and consider the pros and cons of packaging both goods and services in stand-alone sectoral agreements such as the Information Technology Agreement.<sup>53</sup>

### *Regulatory Coherence*

- **Strengthen the transparency of national regulations.** Transparency alone is a factor that decisively contributes to reducing the magnitude of trade friction. Transparency obligations in the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) Agreements are the most far-reaching in the WTO regime. One-stop shops, enquiry points, intervals between the preparation and adoption of measures coming under the aegis of the two agreements constitute important innovations. Regulation, however, extends to areas not covered by the TBT and SPS Agreements. A new, consolidated framework on regulatory transparency should be agreed in the WTO in which:
  - There is a “mapping” of national mechanisms that are intended to provide transparency with respect to national regulatory processes;
  - WTO members notify all adopted measures, whether based on international standards or not;
  - They explain the rationale behind their measures (“reasoned transparency”);
  - They involve affected parties at an early stage in the process;
  - They use the reasonable interval between publication and entry into force of a measure to fine-tune regulation so that it represents a balanced trade-off between genuine regulatory concerns and an effort to minimize the resulting trade impact. It bears repetition that this proposal is not limited to trade in goods;
  
- **Expand the use of the Common Regulatory Objectives model as advanced by Recommendation L of the UN Economic Commission for Europe.** Recommendation L enshrines the “International Model”, which is a set of tools that countries can use to approximate technical regulations in specific sectors. A UN Working Party has taken the lead to implement this Recommendation by fostering “sectoral initiatives” to develop common regulatory frameworks in the areas of telecom, earth-moving machinery, equipment for explosive environments and pipeline safety;

- **Provide observer status to business in the WTO TBT, SPS and other Committees.** Such requests for observer status should not be refused except for compelling reasons to be agreed and transparently communicated. In designing this observer status, the WTO could be inspired by the Business and Industry Advisory Committee of the OECD or the Asia-Pacific Economic Cooperation (APEC) Business Advisory Council. The participation of business interests should not be confined to areas covered by the TBT and SPS Agreements.

### *Competition Policy*

- **Build upon the competitive neutrality principles for state-owned enterprises included in the Trans-Pacific Partnership and EU-Canada CETA agreements.** State-owned enterprises (SOEs) have expanded beyond national borders and the value of their sales equates to around 20% of global trade in goods and services. SOEs frequently benefit from advantages in tax treatment, financing and regulation, denying international competitors a level playing field. SOEs typically also benefit from a dominant market position that allows them to more easily engage in abusive behaviour. Ensuring the appropriate application of competition law to SOEs is thus an objective.<sup>54</sup> The Trans-Pacific Partnership (TPP) and the EU-Canada Comprehensive Economic and Trade Agreement (CETA) include dedicated chapters on SOEs and designated monopolies to address these issues, a trend that future bilateral or plurilateral trade agreement should emulate;
- **Improve cooperation among competition and trade policy authorities.** Governments could anticipate potential trade challenges by inviting their own competition authorities to evaluate the competition consequences of national decisions bearing on tariffs, antidumping, government procurement, foreign direct investment, services regulation and so forth. A core appeal of this approach is that it calls on a domestic market efficiency programme to enforce international trade objectives, so is likely to be less objectionable than the foreign imposition of decisions on national governments.<sup>55</sup> In addition, the informal discussions and coordination that has started to occur in the International Competition Network (ICN), OECD and UNCTAD should be deepened, concentrating on multi-jurisdictional mergers as the most likely source of consequential, inconsistent decisions. Agencies could voluntarily, but effectively, collaborate in joint investigation and enforcement.<sup>56</sup>

### *Digital Economy*

- **Allow the free flow of data across borders** subject to an exceptions provision based on GATS Article XIV concerning the right of countries to protect the privacy of personal data as long as such right is not used to circumvent the provisions of the agreement. The WTO has such a data flow commitment but it

only covers the financial sector, whereas the US-Korea Free Trade Agreement (KORUS) is an example of two countries agreeing to take a broader approach. Such a step should be accompanied by an explicit commitment to eschew data localization requirements, such as that included in the recent TPP agreement;

- **Establish higher, standardized de minimis customs levels** to facilitate cross-border flows of small packages supplied by internet-enabled retail services providers, especially small and medium-sized enterprises. These levels currently range from less than \$1 to \$1,000. Requiring businesses to make customs declarations for goods of small value creates additional transaction costs.<sup>57</sup> According to one study, a 10% increase in time to move goods across borders reduces exports of time-sensitive manufacturing goods by more than 4%.<sup>58</sup> For trade in lower value goods that the internet is enabling, such costs account for a relatively larger share of the goods' total value, making it an even more serious trade barrier. Moreover, it is the consumer that is responsible for completing customs forms and paying the duties, adding another barrier to digital trade. Returning goods are also often treated as imports, which means they are again subject to similar documentation requirements and customs duties. In 2011, 10 APEC members agreed to implement a *de minimis* value of at least \$100, which was estimated to produce a cost savings of \$19.8 billion per year in the APEC region.<sup>59</sup> Developing countries should adopt this or possibly \$200 as a minimum common threshold, with more advanced countries adopting a higher common threshold, such as \$800.<sup>59a</sup>

## Conclusion

Reducing uncertainty and frictions in commercial operations is the key to boosting trade and investment. E15 Expert Groups have proposed a concrete agenda of measures that would greatly increase the simplicity, transparency and coherence of trade rules and arrangements. Many elements of this agenda are ripe for action in the near term, either by governments on their own or in like-minded coalitions. They provide a roadmap for rationalizing the fragmented universe of goods, services, investment, competition, data and other regulations – i.e. for adapting the trade regime to the big changes in the world economy in recent decades that have transformed the operating context for international businesses and investors since agendas for the Uruguay and Doha Rounds were set.



## Accelerating Sustainable Development in Least Developed Countries

Poverty and inequality are major global concerns, as manifested in detailed studies as well as large global compacts, such as the Sustainable Development Goals (SDG) agreed by world leaders. The challenges faced by least developed countries (LDCs) provide a focus for attention for a broader set of concerns faced by poor and low-income economies. The issue of development is multidimensional and is reflected to a significant extent by the criteria used to determine LDCs, combining three different components: per capita gross national income, the Human Asset Index (HAI), based on four indicators,<sup>59b</sup> and the Economic Vulnerability Index (EVI), based on eight indicators.<sup>59c</sup> The HAI measures the nutrition, education and potential skill base of a nation. The EVI measures the structural vulnerability of countries to exogenous economic and environmental shocks.<sup>60</sup>

Forty-eight countries are classified as LDCs. They differ considerably in terms of the various classification criteria, with a very wide variation among them. For instance, gross national income (GNI) per capita ranges from \$119 for Somalia to \$16,089 for Equatorial Guinea, and the HAI ranges from 7.8 for Somalia to 88.8 for Tuvalu. Nonetheless, each is vulnerable and economically weak in terms of the overall criteria considered for evaluating these aspects, and needs major efforts to upgrade its economic and social infrastructure to sustain growth and development. An indication of their relative weakness is provided by the fact that, of the 48 LDCs, the HAI of 44 is less than the global average. The average HAI for LDCs is 51.5 compared to the global average of 75.2. For “under five mortality per 1,000”, the LDC average is 79.4, much higher than the global average of 44.4.

A striking feature of LDCs is the very high level of economic concentration or narrow economic base, and the significant level of vulnerability several of them face, making them highly exposed to shocks. According to the classification of the United Nations Conference on Trade and Development (UNCTAD), 27 of 48 LDCs are dependent on commodities (agriculture, fuels and minerals) for their exports.<sup>61</sup> For many of them, vulnerability arises due to their geography or difficult and fragile domestic conditions. Of the 31 landlocked developing countries (LLDCs), 16 are LDCs, and of the 40 small island developing states (SIDS), nine are either LDCs or recently graduated LDCs.<sup>61a</sup>

LDCs’ low GNI per capita and low HAI scores have major economic and social implications. These indices indicate the scarcity of capital resources available to LDCs, together with the low nutrition, education and skill base of their population. This adversely impacts their domestic level of infrastructure, technology, competitiveness, efforts to diversify their product/export base, and the costs of conducting trade. Capacity and resource constraints also reduce the ability of LDCs to implement large, integrated economic or social initiatives, or to cope with major system changes in markets abroad, such as have begun to take place with mega-regionals like the Trans Pacific Partnership (TPP).

These difficulties lead to a very low level of participation in the global economy, as reflected in the minor share of LDCs in global merchandise trade, as well as foreign direct investment (FDI) inflows. In 2014, the total LDC shares of global merchandise trade and FDI were only 1.3% for exports, 1.5% for imports and 1.9% of global FDI inflows. A noteworthy feature is that Asian LDCs receive considerably more remittances than FDI, whereas for the other LDC groups, the reverse is true (Table 1). This implies an opportunity to improve the movement of labour to provide the skills required in external markets so that remittances could become a more important source of revenue in a wider set of LDCs.

**Table 1: FDI Inflows and Remittance Inflows for LDCs, 2013 (Million US\$)**

	<b>FDI 2013</b>	<b>Remittances 2013</b>
<b>African LDCs and Haiti</b>	21,801	9,179
<b>Asian LDCs</b>	5,943	21,328
<b>Island LDCs</b>	213	166
<b>LDC Total</b>	27,957	30,673

Source: “The Least Developed Countries Report 2014”, UNCTAD, Geneva, 2014, pp. 13 and 15

LDCs’ export products tend to lose out to competition and thus are more likely to be phased out of the market than those of other developing economies.<sup>3</sup> A focus on competitiveness requires emphasis on cost efficiency. LDCs incur relatively higher costs in export and import: in some cases, about one and a half times that of others.<sup>4</sup> Their markets are smaller and their infrastructure/skill base lower, which implies a larger presence of small and medium-sized enterprises (SMEs), and relatively simpler technology production.

### **Building on Recent Major Global Initiatives**

The diverse characteristics of LDCs suggest multiple challenges must be faced and a combination of policies is needed to address them. In recent years, a number of important global initiatives have been taken to work with LDCs in several of these areas. These include, inter alia, the Programme of Action for the Least Developed Countries for the Decade 2011-2020,<sup>62</sup> the 2030 Agenda for Sustainable Development,<sup>63</sup> and as laid out by the outcome document of the Third International Conference on Financing for Development, the Addis Ababa Action Agenda.<sup>64</sup>

These initiatives provide a far-reaching agenda for assisting LDCs and others to achieve the SDGs. They cover a large number of issues. For conceptual ease, the different initiatives are shown below under different broad and somewhat overlapping categories, which contribute to the development process. The examples provide only an indication of the vast scope of the various efforts, which extend much beyond the illustrations given.

- a. Institutional/economic issues
  - Developing local capital markets;
  - Helping with project preparation for investment;
  - Providing financial support for project preparation to attract investment in LDCs;
  - Facilitating access to information on investment facilities and risk insurance and guarantees;
  - Reducing transaction costs to less than 3% for migrants' remittances;
  - Scaling up international tax cooperation;
  - Developing rural areas and sustainable fisheries;
  - Increasing investment in rural infrastructure, agriculture research and technology development;
  - Bridging the infrastructure gap;
  - Expanding infrastructure and upgrading technology for supplying modern and sustainable energy services;
  - Providing financial assistance to build sustainable and resilient buildings;
  - Raising capacity for effective climate change related planning and management;
  - Addressing illegal, unreported and unregulated fishing and destructive fishing practices;
  - Developing many trade related initiatives.
  
- b. Social initiatives
  - Developing initiatives in health and education;
  - Addressing poverty, hunger and food security.
  
- c. Development cooperation
  - Promoting enhanced capacity-building support;
  - Increasing Aid for Trade;
  - Encouraging official development assistance (ODA) providers to give at least 0.20% of ODA/GNI to LDCs;
  - Enhancing development cooperation;
  - Developing quality and timely development data;
  - Strengthening national data systems and evaluation programmes;
  - Strengthening the capacities of municipalities and other local entities;
  - Coupling graduation process of LDCs with appropriate measures so as to not jeopardize the development process and progress towards sustainable development;
  - Strengthening scientific, technological and innovative capacities.

## **The Role of International Trade and Investment**

International trade is very important for LDCs. The ratio of international trade to GDP is relatively high, and it is positively correlated with human development index scores. The ratio for LDCs in the low human development category is 72.7%, increasing to 92.5% for LDCs in the medium human development category. This shows a very high degree of reliance on trade for LDCs, implying that it should be one of the priority areas for action.

Trade and investment are both important for addressing the scarcity of resources, skills and infrastructure.<sup>5</sup> Further, in our interconnected world in which trade and investment overlap, it is essential to maintain or improve competitiveness to develop LDC economies and become more effective participants in global markets. To create links between domestic and foreign markets, LDC policy-makers need to develop mechanisms for collaborative interaction with private and public sector stakeholders, nationally, regionally and globally. The implementation of trade facilitation reforms, such as the setting of de minimis levels below which customs duties are not collected, is especially valuable for LDCs.

Though efforts to address the trade concerns of LDCs have been going on for many years, a careful analysis of both the underlying conditions and how they are likely to evolve over the next decade is required to substantively bring practical solutions to bear upon the issues faced by LDCs. The output of the E15 Initiative is significant in this context. The E15 Expert Groups on Global Trade Architecture, Finance and Development, Agriculture and Food Security, Regional Trade Agreements, Global Value Chains, and Services, as well as the Expert Task Force on Investment Policy, have made a series of proposals that together amount to an ambitious yet feasible agenda to strengthen the contribution of international trade rules and arrangements to the pace of sustainable development in poor countries by:

- Maximizing preferential market access;
- Improving the terms of foreign investment;
- Increasing financing for trade-related development;
- Ensuring the inclusivity of norm setting and adoption;
- Deploying official ODA more strategically.

### **Maximizing Preferential Market Access**

The World Trade Organization (WTO) Doha Round of multilateral trade negotiations – or Doha Development Agenda – has thus far been unable to fulfil its fundamental objective of improving the trading prospects of developing countries. But the E15 Expert Groups on Global Trade Architecture, Finance and Development, and Agriculture and Food Security outline several other important, practical steps that can be taken in the coming years to improve access by LDCs to the markets of

their wealthier counterparts, regardless of the ultimate disposition of the Doha Round.

- **Expand duty-free, quota-free access.** Developed and major emerging market countries have made significant progress over the past decade in according duty-free, quota-free (DFQF) access to their markets of products from LDCs. However, this progress is uneven; it is often thwarted by restrictive and complicated rules of origin requirements, and it is progressively being eroded by the proliferation of regional free trade agreements. Following is a set of proposals to reinforce this important aspect of the trading system's support for the economic development of low-income countries:<sup>65</sup>
  - **Developed countries should extend full DFQF market access for all LDCs.** A phased programme could be devised by the United States to address the small number of apparel tariff lines that are important for Sub-Saharan African exporters and covered by the African Growth and Opportunity Act. The European Union, Canada and Japan have gone beyond the 97% of tariff line coverage agreed at the 2005 WTO Hong Kong ministerial meeting and essentially met this objective; however, the preference schemes of some, most notably the United States, still fall short. Studies show that excluding even 3% of tariff lines from DFQF programmes can significantly undermine the value of LDC participation.<sup>66</sup> For example, Bangladesh and Cambodia face average tariffs of over 15% on their apparel exports to the United States, generating customs payments that are equal to or greater than those paid by the much larger French and British economies on all of their US exports (\$460 million and \$480 million, respectively)<sup>67</sup>;
  - **Middle-income countries should follow the leadership of China, India and Brazil by implementing DFQF programmes that attain 97% tariff line coverage** within the next 5 to 10 years. China expects to reach this goal by the end of 2015 for LDCs with which it has diplomatic relations. India and Brazil have announced similar plans, but these have yet to be fully implemented. Other middle-income countries should demonstrate a similar degree of commitment to South-South trade and the eradication of absolute poverty by following suit;
  - Both groups of countries should follow the leadership of Canada and **implement rules of origin for these preference arrangements using an extended cumulation approach, forming, in effect, a broad cumulation zone** among all LDCs and countries that are members of free trade agreements (FTAs) in which the importing country participates. This approach would significantly stimulate exports from and commerce among LDCs, judging from the evidence of similar rule of origin changes in the past, such as a shift from a double to single transformation requirement, which produced large increases in exports;<sup>68</sup>

- These steps would markedly improve both *de jure* and *de facto* market access for LDCs around the world. None would require a multilateral agreement; they can all be achieved through the initiative of individual states or coalitions thereof.

### Improving the Terms of Foreign Investment

The Expert Task Force on Investment Policy has developed proposals for improving the international investment regime and striking a better balance among investor, host government and citizen interests therein. The regime now consists of about 3,300 bilateral and plurilateral agreements – up tenfold in the last 25 years. The Group suggests building on the recent changes that have been incorporated in model investment agreements of countries as diverse as Norway and India, as well as the work under way and mandated by the United Nations Financing for Development conference in Addis Ababa at UNCTAD, in the following manner:

- Create a consultative process to develop an **updated articulation of the overall purpose** of international investment agreements (IIAs). The process would encompass not only investor protection against arbitrary measures but also the facilitation of sustained investment in sustainable development and the preservation of a certain degree of domestic policy space to protect public safety and health.
- Use the Investment Policy Framework for Sustainable Development recently issued by UNCTAD as a starting point for this process. It would seek to build common ground on not only the articulation of and set of definitions for this restatement of the purpose of IIAs but also the **design of the main elements of a 21st century international model agreement**, which would help negotiating parties to **strike a better balance regarding the preservation of essential national policy space**, including:
  - An articulation of **fundamental investor obligations**, including with respect to responsible business conduct in areas like corruption, human rights and taxation (i.e. for example, the new OECD Base Erosion and Profit Shifting framework). Supplemental sector-specific responsible investment frameworks could be developed through public-private dialogue, such as in the area of responsible mineral and natural resources development;<sup>69</sup>
  - A new **international appeals framework** that states could choose to opt into as part of their bilateral agreements or FTAs. This mechanism would provide recourse for either party of an arbitral judgment to an ad hoc appellate body composed of members from a pool of investment adjudication specialists accredited by the international framework.

- Level the playing field for developing country governments that lack the legal expertise to defend themselves adequately. An **Advisory Centre on International Investment Law** could be established, modelled on the Advisory Centre on WTO Law. Created in 2001, this provides services to developing countries through its own staff or outside counsel at reduced rates.
- Foster donor country assistance and support for **capacity building to developing countries** in the implementation of the new model framework. This can be done by extending the WTO Aid for Trade initiative to cover investment-related as well as trade-related capacity building. These programmes of assistance could be shaped by the Investment Policy Reviews of UNCTAD or relevant reviews by OECD or the WTO.
- Promote technical assistance from the International Monetary Fund or multilateral development banks to LDC sovereign debt issuers. **This would ensure they have the capacity to negotiate terms based on the model frameworks** developed recently to eliminate judicial/sovereign risks, and in turn provide for efficient restructurings should the need arise. In 2014, a group representing the world's largest banks, investors and debt issuers (the International Capital Markets Association) created a new framework for bonds that they hoped would address problems faced during the Argentine debt crisis and Greece's 2012 debt restructuring when holdout investors resisted deals and demanded full payment; however, this model language has yet to be widely used by developing country governments, including in Sub-Saharan Africa.<sup>70</sup>

### Increasing Financing for Trade-Related Development

One of the most important development constraints LDCs face is a low level of private investment, both foreign and domestic. This prevents them from taking full advantage of existing export opportunities and new ones created by market opening initiatives, such as those proposed above. Recently, this problem has been exacerbated by a new and worrisome constraint in the availability of trade finance. The Expert Groups on Finance and Development, Services, and Global Value Chains, as well as the Expert Task Force on Investment Policy, propose the following action agenda in response:

**Ensure correspondent-banking availability.** Banks have sharply cut down on their correspondent-banking networks as the costs of regulatory checks, such as Know Your Customer (KYC) activities related to anti-money laundering, have far outpaced the growth of business potential. Though hard data is scarce, it is believed in the banking community that the sharpest cuts have been made in low-income countries, to the point that some of these countries are on the verge of being excluded from international financial networks. The consequence of this financial exclusion is particularly serious when it comes to the exchange of goods and services since, without the ability to exchange information or funds, local companies struggle to enter into the contractual obligations that underpin

international trade. The economic development of many low-income countries is therefore severely compromised. The Expert Groups' proposal is that each country should house at least one local bank with a fully-fledged correspondent-banking arrangement with international financial institutions. Following are the key steps involved in bringing this proposal to fruition, which have recently been endorsed by the Chairman of the Financial Stability Board and Chief Financial Officer of the World Bank Group:

- Initiate sponsoring/mentoring by the Bank for International Settlements, the Financial Stability Board or the Wolfsberg Group,<sup>70a</sup> leading to the improvement of the local correspondent bank(s)'s governance structure;
- Have the KYC process validated by the sponsor so that it will be deemed to be sufficient for international regulatory purposes;
- Secure an international ruling to ensure that developed country banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s).

**Deploy official development assistance (ODA) more strategically.** LDCs and their international development partners need to develop a strategic vision regarding the efficient and effective use of ODA for private sector development in the coming years.<sup>70b</sup> The four key building blocks of this new vision are the following:

- Enhancing the flows and quality of ODA. This would allow more targeted and results-oriented projects geared towards promoting specific elements of the enabling environment, such as social, economic and digital infrastructure, as well as productivity-enhancing public institutions and productive sectors.
- Increasing the use of blended finance to scale up investment. This can be done by leveraging other sources of finance (including private finance), by enhancing project impact (by keeping broader public welfare concerns well in view) and by ensuring financial returns (for private investors and others) by reducing the average cost of capital, funding viability gaps and providing guarantees against various kinds of risks prevalent in low income economies.
- Creating a more business-friendly policy environment by strengthening national capacities for accelerated domestic reforms. This is needed particularly in the financial sector, in public expenditure systems and in the area of the rule of law, thereby ensuring greater financial mobilization and a more efficient use of these resources.
- Emphasizing the role that ODA can play in dampening a country's exposure to shocks. Ensure that at least part of the allocation of conventional ODA depends on structural economic vulnerability, and make sure that conventional ODA is not merged with additional resources geared towards LDC adaptation to climate change, based on physical vulnerability indices.<sup>70c</sup>

Expand the scope and scale of trade-related capacity building and the Aid for Trade initiative. Domestic institutions – in particular, legal frameworks and the public agencies that administer and enforce them – are crucial for the purpose of attracting private investment because they strongly influence investment risk. But despite the centrality of private sector development and finance to economic growth and job creation, capacity-building assistance for investment climate institution building has been a minor focus of official development assistance. Several E15 Expert Groups proposed major increases of such aid for the development of rules and administrative and adjudicatory capacity in the areas of services, legal and regulatory reform, investment frameworks, private standards adherence, responsible supply chain practices and global value chain mapping against domestic capabilities, anti-corruption, etc. While the Aid for Trade initiative has made important progress since it was launched 10 years ago, it and the bilateral donor programmes that underlie it need to substantially broaden their scope and considerably boost funding levels so that a fuller spectrum of institutional weaknesses that raise trade costs and generate investor uncertainty can be adequately addressed in LDCs. The Services Expert Group and the Investment Policy Expert Task Force call for services and investment facilitation frameworks analogous to the Trade Facilitation Agreement, in which a phased approach to implementing commitments is to be coupled with capacity-building assistance. This approach has great promise for facilitating trade and mobilizing additional finance for development, but it is predicated upon a structural shift in the focus and volume of trade-related capacity-building assistance.

Establish an agricultural subsidy solidarity fund to support food security and climate change adaptation in at-risk LDCs. Developed countries are continuing to resist major new international commitments to reduce farm supports due to stubborn domestic political realities, while emerging economies have recently become major users of similar, trade-distorting subsidies in their own right. At the same time, the share of official development assistance targeted at agriculture, forestry and fisheries has declined precipitously, down from around 20% in the 1980s to close to 5% today,<sup>71</sup> even as high commodity prices and an increased prevalence of weather-related crop failures due to climate change are posing serious food security challenges in many low-income countries. A constructive, if partial, step forward on LDC agriculture proposed by the E15 Agriculture and Food Security Expert Group would be to create a **solidarity fund in which financial contributions would be made in proportion to the magnitude of such domestic support.** With total ODA to agriculture in the order of \$9 billion and official trade-distorting support (OTDS) to agriculture in all developed and emerging countries amounting to about \$200 billion, a contribution of even just 1% or 2% of OTDS by each donor country would result in an expansion of ODA to agriculture by 20% to 40%, funds that could support a significant boost in capacity-building assistance for climate-smart agricultural productivity improvements and export performance in at-risk LDCs.<sup>72</sup>

**Increase domestic resource mobilization in developing countries by boosting capacity-building assistance for the development of stronger domestic tax institutions and more transparent tax rules.** Developing countries are chronically short of the funds needed to support their development, as the July 2015 United Nations Financing for Development conference in Addis Ababa highlighted. Increasing the tax raised in developing countries would help plug this financing gap, including for the kinds of essential economic institutions outlined above. Half of Sub-Saharan African countries still mobilize less than 15% of their GDP in tax revenues, below the minimum level of 20% considered by the United Nations as necessary for development. Several Asian and Latin American countries fare little better. Tackling “base-erosion and profit-shifting” (BEPS) by multinational enterprises (MNEs) could substantially increase tax collection by developing country governments. A recent International Monetary Fund paper estimated that developing countries could lose \$213 billion a year in the long run, close to 1.3% of their GDP, from BEPS.<sup>73</sup>

Notable recent progress under the OECD BEPS initiative includes: (1) a new international “Common Standard” for automatic exchange of information between tax authorities (modelled on the US Foreign Account Tax Compliance Act); and (2) the introduction of country-by-country reporting requirements that will require MNEs to provide specific aggregate information annually to tax authorities in each jurisdiction where they do business, including on the global allocation of income and taxes paid. For developing countries, more support is needed in two areas. First, to strengthen domestic institutions and legal arrangements so they can implement new international standards and, second, to strengthen the international tax system so it facilitates the work of developing country tax authorities. Concrete steps that could be taken include:

- Increase capacity-building efforts on BEPS in developing countries, including by developing toolkits and providing guidance to support the practical implementation of the OECD BEPS measures and other related priority issues (international assistance can be a powerful catalyst for domestic resource mobilization: for example, with modest international support, revenue collection from transfer pricing audits in Kenya has doubled from \$52 million in 2012 to \$107 million in 2014);<sup>74</sup>
- Increase the automatic exchange of information between tax authorities, prioritizing the transfer of information to developing country tax authorities;
- Increase the reporting by MNEs to tax authorities, for example by creating a public tracking system that enables the ready assessment of progress against international BEPS targets;
- Strengthen the involvement of developing countries in international BEPS initiatives, including those led by the OECD;<sup>75</sup>

- Ensure that all licences and concessions are subject to transparent bidding procedures, including as regards non-commercial objectives;
- Increase transparency for commodity prices and volumes in international markets; Increase transparency of the commodity trading sector and its regulation.

### Expanding the Inclusivity of Norm Setting and Adoption

Capacity and resource constraints reduce the ability of LDCs to be appropriately informed, or to provide input to or adapt to cope with major system changes in markets and trade regulation. LDCs have limited access to the related decision-making processes and their concerns demand further attention. Meeting the standards of a TPP, for example, is not possible for LDCs, yet access to these markets is crucial.<sup>75a</sup> Inevitably, large new trade and investment agreements will become the *de facto* regime for global trade regulation. E15 experts suggested the following as a basis for enabling wider and more effective LDC participation in norm setting in a world of variable trade and investment geometry:

- **Establish regional platforms for excellence.** These platforms or centres would provide information, training and dialogue opportunities to clarify global regulatory initiatives and market developments and advise on necessary steps, including regional development bank funding. They would provide an opportunity for interaction with lead firms by both governments and SMEs, helping upgrading to meet the requirements of global value chains.
- **Augment capacity to conform to streamlined global standards.** Beyond a certain level of market penetration, private standards should welcome scrutiny and oversight by international public bodies and civil society. International institutions could assist with the promotion of key principles and guidelines to bring greater conformity to major private and public standards. Assistance for SMEs to meet the requirements of private standards could feature in official aid programmes. Assistance to comply with Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) Agreements is a recognized element of Aid for Trade. Capacity building for governments to conduct conformity assessments is also needed, and in this context it would be desirable to strengthen the Standards and Trade Development Facility – a partnership between the Food and Agriculture Organization of the United Nations, the World Organisation for Animal Health, the World Bank, the World Health Organization and the WTO.
- **Encourage inclusivity in regional and plurilateral agreements.** Negotiators of new non-multilateral agreements could create conditions to extend benefits to LDCs, such as providing for exports from LDCs to fit within the Rules of Origin of the agreement. More broadly, the time is ripe to devise principles by which the emerging mega-regional regime can connect more easily with the multilateral system. This could be structured as an Agreement to Facilitate an Inclusive Roadmap for Sustainable Trade.

**Create an Institutional Readiness Index to guide LDCs and development partners in setting priorities for the support of economic institution building.**

The nature and success of the implementation of policy reform vary considerably across LDCs, with some making very significant progress in improving their economic and social performance, while others are still lagging considerably behind most other nations. This becomes clear when using a range of indices to measure the performance of nations in terms of market efficiency and human development. The Ease of Doing Business (EOB) Index, Human Development Index (HDI), Logistics Performance Index (LPI), Competitiveness Index (CI) and Enabling Trade Index (ETI) are considered below. For each of these indices, most of the countries in the lowest ranks are LDCs. Table 2 shows some of the top LDC performers according to different indices.

**Table 2: Top Five LDC Performers for Selected Indices (with their rank for the Index)**

<b>EOB</b>	<b>HDI</b>	<b>LPI</b>	<b>CI</b>	<b>ETI</b>
Rwanda (46)	Timor-Leste (128)	Malawi (73)	Rwanda (58)	Rwanda (66)
Bhutan (71)	Vanuatu (131)	Rwanda (80)	Lao PDR (83)	Zambia (91)
Vanuatu (94)	Kiribati (133)	Cambodia (83)	Cambodia (90)	Cambodia (93)
Zambia (97)	Bhutan (136)	São Tomé and Príncipe (84)	Zambia (96)	Lao PDR (98)
Nepal (99)	Cambodia (136)	Burkina Faso (98)	Nepal (100)	The Gambia (99)

Note: Bhutan and Cambodia have the same value for their HDI. For EOB, Cambodia’s rank is 127. Sources: World Bank Group, “Doing Business”, Economy Rankings, available at <http://www.doingbusiness.org/rankings>; World Bank, “Logistics Performance Index”, Global Rankings 2014, available at <http://pi.worldbank.org/international/global/2014>; World Economic Forum, “The Global Competitiveness Report 2015-2016”, available at <http://reports.weforum.org/global-competitiveness-report-2015-2016/>; United Nations Development Programme, “Human Development Report 2014”, available at <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>; World Economic Forum, “Competitiveness Rankings”, available at <http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings/>; World Economic Forum, “The Global Enabling Trade Report 2014”, available at [http://www3.weforum.org/docs/WEF\\_GlobalEnablingTrade\\_Report\\_2014.pdf](http://www3.weforum.org/docs/WEF_GlobalEnablingTrade_Report_2014.pdf)

Rwanda and Cambodia occur most frequently in the table, followed by Zambia. For trade, logistics and competitiveness issues, Rwanda is a leader in the group of top performers. It is not among the top five for the HDI (its rank is 151), but even in that context it has registered a very good performance by making the largest improvement in the world in terms of its HDI ranking, by moving up 17 places from 2008 to 2013. This indicates that improving competitiveness and economic performance also contributes towards improving the human development performance of a nation.

The countries mentioned in Table 2 are leading performers and have made important efforts to improve their socio-economic conditions. They could provide an illustration of the policy steps needed for LDCs. Similarly, the World Bank shows that the 10 economies improving the most across three or more areas measured by the EOB included four LDCs, namely, Benin, Togo, Senegal and the Democratic Republic of Congo.<sup>76</sup> Likewise, in the list of areas covered by the EOB Index, LDCs were among the countries that improved most in 2013-2014 for some of these areas: starting a business (Timor-Leste), getting electricity (Solomon Islands), trading across borders (Myanmar) and resolving insolvency (Mozambique).<sup>77</sup> The experience of these LDCs can provide some guidance on steps that would help make progress for other LDCs as well.

The experience of these success cases illustrate that important policy reforms<sup>77a</sup> include facilitating investment and trade, improving the effectiveness of transport and logistics, rehabilitating and improving roads, increasing the transparency of operations, simplifying policies, including licensing and reporting procedures, introducing time limits for issuing licences, ensuring the computerization of licensing and customs operations (e.g. using the Automated System for Customs Data), moving towards single window solutions, increasing awareness through training programmes for customs and other policy-makers/businesses, launching a trade portal or ease of doing business portals to facilitate transparency and the dissemination of information, automatic clearance mechanisms or pre-clearance schemes, and improving access to finance.

To support the strategic deployment of domestic resources and ODA for these purposes, the E15 Expert Group on Finance and Development suggests developing an Institutional Readiness Index. Given the importance of financial markets in enabling development and the efficient functioning of markets and institutions, the experts suggest some factors that are not fully covered by the above-mentioned indices. These include:

- A Herfindahl index of concentration in the banking sector;
- The existence of a functioning antitrust authority;
- An indicator of fluidity of visa policy, including the ease of obtaining a short-term visa;
- The number of correspondent foreign banks;
- The existence of a national or regional credit bureau and/or a rating agency;
- The legal system under which sovereign bond issuance takes place.

These six factors combined would give us an Institutional Readiness Index that could in turn be combined with other indices, such as the EOB and HDI to create a tool for policy planning, a two-dimensional Index for Policy Planning.

## Conclusion

E15 Expert Groups have developed an ambitious yet practical agenda of changes in the international trade and investment regime that would deliver major benefits for LDCs. If implemented, these changes would result in zero tariffs on essentially all LDC exports (including agriculture) to developed countries and on nearly all such exports to major middle-income countries. Foreign assistance for agriculture productivity improvements, export market readiness and climate adaptation would rise by roughly a third. The Aid for Trade initiative would be expanded in scope so that it henceforth supported the building of effective legal and regulatory, services and investment institutional frameworks and administrative capacity, which are critical for attracting job-creating investments in the modern global economy. Current trade financing constraints would be addressed on a priority basis by financial regulators, and assistance would be provided to strengthen the hand of LDC governments in the structuring of FDI, sovereign debt issuances and tax dealings with international companies.

These proposals demonstrate that much can be done within trade-related rules and institutions to accelerate the sustainable development of LDCs. Moreover, these changes need not await the conclusion of a formal multilateral trade negotiation. They simply require a commitment by key countries to follow through on the spirit of Hong Kong, Addis Ababa and the recently concluded New York United Nations Sustainable Development Summit with a series of steps that would require little of any individual economy but together would generate major gains for the poorest countries on the planet.

## Increasing Economic Diversification and Competitiveness in Middle-Income Countries

The diversification of products, skills and market linkages has historically been an important objective as well as indicator of development. Diversification has been considered important to address declining terms of trade for primary products, to limit the adverse effects of volatility and risk, and to improve the stability of the growth process.

The diversity of domestic products is a significant indicator of improvement in domestic capabilities and systems, the ability to move up the value chain, and link up with new technologies and “sunrise” industries. A diversified product and export structure tends to reflect greater capabilities and competitiveness. More recent work has shown that it is also a good indicator of the growth potential of an economy. Thus, for example, Dani Rodrik (2004) states: “Whatever it is that serves as the driving force of economic development, it cannot be the forces of comparative advantage as conventionally understood. The trick seems to be to acquire mastery over a broader range of activities, instead of concentrating on what one does best.”<sup>78</sup>

Normally, diversification is considered in terms of the product or export structure of an economy. However, products are only a reflection of underlying skills and technological capabilities. Ricardo Hausmann (2013), who has done extensive research into these issues, is emphatic about the importance of capabilities. He says: “The diversification that matters is at the level of capabilities. It is expressed in the variety and complexity of the products that countries are able to put together.”<sup>79</sup> Likewise, Rodrik (2013) says, “Only countries that steadily enhance their fundamental capabilities eventually become rich.”<sup>80</sup> The economic situation that leads to low diversity indicates lack of human capital, education levels and skills, financial instruments, technology and knowledge, and innovation base. The factors, capabilities and productivity that provide a basis for and are reflected in product diversification contribute also to competitiveness.

As Sharmila Kantha (2015) states: “Competitiveness is a broad term, extending to the ability of nations and industries to expand their presence in global markets. ... It is important to keep in mind developments in international markets because this indicates global performance criteria and the kind of competition that domestic producers will have to face in accessing global value chains” (emphasis added).<sup>81</sup>

The sometimes footloose nature of production of global value chains only underscores the importance of diversification. As production capacity is now shifted more easily from one location to another, international investors can move on once wages are bid up in the current location, making it harder for hosts to upgrade and transition to higher levels of activity.<sup>82</sup> But evidence shows that those that are able to diversify and shift to higher-value-added activities grow faster than those that focus purely on remaining competitive within their traditional areas of competence.<sup>83</sup>

The challenge for middle-income countries (MICs)<sup>84</sup> of navigating this transition and becoming high-income countries (HICs) is immense, as they face increasing competition in three different kinds of markets. In their traditional markets, they face growing competition from high-growth low-income countries (LICs); in their new markets, the competition is from established technically complex products from other MICs and HICs, and in their “aspirational” markets, it is from emerging highly sophisticated products from HICs that dominate those markets. As MICs attempt to operate in new markets, HIC producers upgrade their own technologies to maintain their market share.

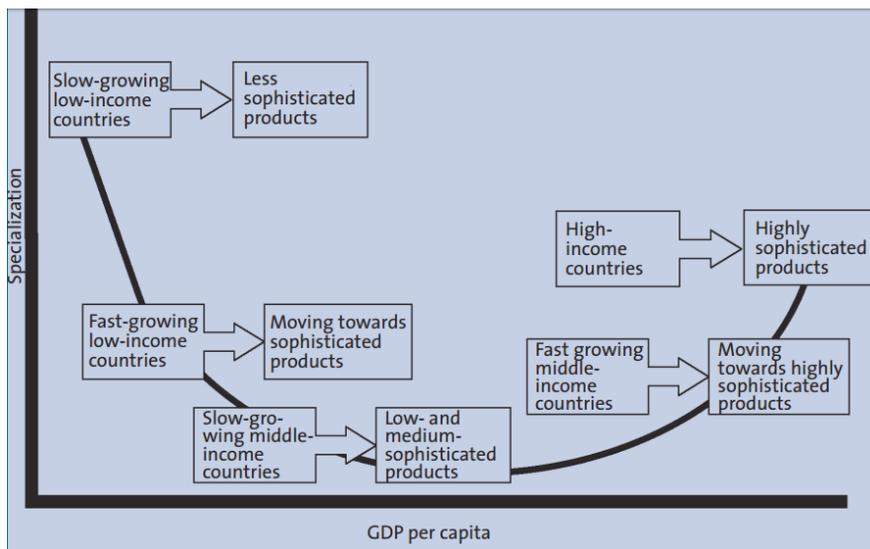
Thus, MICs face strong challenges in both their traditional and new markets, combined with the immense difficulty of raising technological capacities. They risk being snared in a “middle-income trap.” The only way for MICs to break out of this trap is to improve domestic competitiveness at the level of the firm, industry and the nation itself. Policy support and incentive systems, combined with the requisite institutions, infrastructure, capabilities and governance, are recognized as important to drive a virtuous circle of improved competitiveness, diversification and sustained growth and improvements in living standards.

Diversification can consist of both providing a larger number of products without much improvement in technological capabilities, or increasing technological complexity, including in different parts of the supply chain. Diversification can take place through efforts to copy existing products or implement established technologies, to develop capabilities to move towards new technologies, or to improve the existing frontier technologies to produce new ones. Development combines each, though sustained economic growth requires increasing capabilities over time. However, the creation of diverse, complex and technology-intensive products is not necessarily job-intensive. The challenge is to keep improving technological capabilities while maintaining a momentum to provide jobs in the economy.

Since greater product diversity is normally associated with richer economies, a positive relationship is expected between GDP per capita and diversity: the richer a country, the greater the diversity of its production and exports. However, this relationship is actually in the form of an inverted U-curve for both domestic products as well as exports.<sup>85</sup> As per capita income rises, the diversity of domestic products and exported products increases up to a point and then declines.

In contrast, the relationship of GDP per capita with product sophistication appears to be a linear one: the richer a country, the more sophisticated the product structure of that nation. These two different relationships can be seen in Figure 1. The left axis shows specialization, i.e. the opposite of diversification.

**Figure 1:** Relationship between Specialization, Diversity, Sophistication and GDP per Capita



Source: UNIDO (2009, page 18)

### High-Income Countries

One feature of the high-income countries is that they produce very sophisticated products that few other countries are able to make. These products require high-level capabilities that are not prevalent in a large number of countries. Therefore, very sophisticated products are less ubiquitous than simpler ones. Given the need for HICs to keep improving their competitive abilities in the markets they dominate, their policy focus is on continued improvement of their technological base. Table 1 shows the importance of R&D for HICs. It is noteworthy that defensive industrial policy is temporary and used to address situations that arise infrequently. Thus for HICs, catch-up and innovation-based industrial policies are the main focus. Since the niche for HICs is in areas with sophisticated products, their policy support has R&D as an important part of its emphasis.

**Table 1: Industrial Policy in High-Income Economies**

Type	Examples	Policy Instruments	Implications for WTO Rules
<b>Defensive Industrial Policy</b>	Adjustments to oil shock in the early 1970s and to the 2008-2009 financial crisis (UK, France, US, Japan)	Provision of credit, training grants, demand stimulus, temporary import restrictions	Potential challenge where specific subsidies or export subsidies exist
<b>Catch-up Industrial Policy</b>	National Champion policies in the 1960s and 1970s (UK, France, Japan, Korea)	Provision of credit, seed funding, and tax incentives for R&D, merger policy	Potential challenge to specific subsidies in relation to differential incentives
	Foreign investment promotion (Ireland, Czech Republic, Spain)	Tax incentives, investment grants, package of support measures	
<b>Innovation-based Industrial Policy</b>	Innovation and competitiveness policies (EU, UK, France, US, Japan)	Finance for basic research and its commercial application, R&D tax credits, procurement policy, higher education policy	Potential challenge to specific subsidies to innovation

Source: Weiss, 2015<sup>66</sup>

Several insights for policy-making emerge from the E15 Initiative:

1. The process of development requires the production of more sophisticated products and greater diversification of both products and capabilities.
2. This implies a need for the continued expansion of capabilities, skills and infrastructure that will facilitate the application of these capabilities to new product areas.
3. Diversification takes place more easily by progressing incrementally from existing products and capabilities to “related” products, i.e. products with similar input, infrastructure and capability requirements. Thus, it is useful to identify such “related” products for possible focus.
4. Meeting the incremental requirements of new production can enable a wider impact through increasing concentric circles of economic activity.

5. Instead of considering these issues only in domestic terms, the opportunities available through trade, investment and collaborative efforts among nations need to be taken into account.

### **Diversification, Competitiveness and Trade Policy**

New technologies and capabilities that are not domestically available must be obtained from external sources largely through trade and investment. Further, as global value chains (GVCs) come to dominate international markets, policies have to facilitate links to such chains. Conveniently, policies intended to encourage competitive domestic value chains are similar to those needed to facilitate links with GVCs; thus, improvements in one tend to lead to improvements in the other.

Connections with international markets and investment have direct and indirect effects on efficiency, and are important instruments for increasing both spillovers and access to technology.<sup>87</sup> Studies show that countries better linked to international markets tend to have more dynamic growth.<sup>88</sup> Both domestic and trade policies need to be oriented towards sustaining competitiveness through improving quality and cost-efficiency, meeting the standards-oriented demand in global markets, quicker communication, and facilitation policies rather than the restriction of economic transactions.

Within GVCs, opportunities for upgrading and diversification may be present both upstream and downstream, in goods or services. A difficulty is that lead firms work to retain control over the higher value-added activities and developing country firms can encounter significant barriers to entry to higher-value segments.<sup>89</sup> At the same time, the best practices of global firms and disciplines of international markets are crucial learning opportunities for new participants.

The policy option paper from the E15 Expert Group on Industrial Policy states that, “whether a country stays stuck in the middle-income trap depends on several factors. Most importantly, it depends on the policies adopted for continuously improving productivity and innovation, through better infrastructure, skills, and links with high-technology and high-productivity activities”.<sup>90</sup> Complementary steps include monitoring and reducing constraints and problems for producers and investors, timeliness and predictability in governance,<sup>91</sup> and cooperation between government and industry to devise the most efficient and effective policies.

Indeed, the evidence on industrial development during the past 50 years, including particularly the experience of a number of successful East Asian economies, suggests that horizontal (non-sector specific) policies to improve the enabling environment are ultimately more important to success than vertical (sector- or firm-specific) ones. Specifically:

- Improvements in **infrastructure, education and training, enterprise development, entrepreneurship, innovation, finance and social policies** create the potential for positive spillover effects from early manufacturing successes to take root and spread locally
- In particular, by combining **parallel improvements in the enabling environment for private sector and skills development with openness to hosting foreign direct investment** in key sectors, countries create the possibility for technology and know-how from those foreign firms to be transferred more widely and organically through the bottom-up creation of forward and backward linkages. These linkages can build over time into clusters of industrial capabilities that propagate local production, investment and innovation.
- These clusters can be reinforced and accelerated through efforts to attract investments by lead firms in global or regional value chains by maintaining a hospitable tariff and non-tariff barrier environment for the importation of key inputs, including improvements in trade facilitation (particularly customs and logistics). In this sense, **modern industrial policy emphasizes *the facilitation rather than restriction* of imports and inward foreign investment.**
- This brand of industrial policy, which has been employed with considerable success in many of today's upper middle income countries, **requires a systems approach** – i.e., a recognition that successful industrial development is a process of ongoing upgrading of particularly skills, infrastructure and economic institutions, not least the professionalism and insulation from rent-seeking behaviour of vested interests of economic policymaking and regulatory institutions.
- This approach can be usefully combined with vertical policies such as some of those highlighted above, but based on a recognition that these more targeted initiatives are more likely to be effective and cost-efficient when they are executed within a robust horizontal enabling environment and determined through a **rigorous and dynamic evaluation of the country's latent competitive advantages** in the ever shifting international economic context.

The E15 Expert Groups on Investment, Services, Global Value Chains, Competition, Digital Trade and Industrial Policy propose several significant ways in which the international trade and investment regime can be strengthened to help countries translate improved horizontal enabling environment conditions into increased

flows of foreign investment and commerce that reinforce the process of economic diversification. Much of this agenda concerns facilitation rather than the creation of new norms, particularly in respect of cross-border investment, services and regional and global value chains that are vehicles for introducing additional capital, technology, know-how and skills transfer into an economy. Specifically:

### Supporting Inward Investment

The E15 Investment Task Force proposes creation of an international support programme for sustainable investment facilitation, focused on improving *national* FDI regulatory frameworks and strengthening investment promotion capabilities (Sauvant and Hamdani 2015).<sup>6</sup> Such a programme would concentrate on practical ways and means—the “nuts and bolts”—of encouraging the flow of sustainable FDI to developing countries.<sup>7</sup> Such a programme would complement the various efforts to facilitate trade, notably those governed by the WTO-led Aid for Trade Initiative and the recently adopted WTO Trade Facilitation Agreement (TFA—which focuses on practical issues related to trade and does not deal with yet contentious issues such as the WTO-committed access conditions for agricultural and other products). In fact, in a world of global value chains, the Aid for Trade Initiative and the TFA address one side of the equation, namely the trade dimension, while an international support programme for sustainable investment facilitation would address the other side of the equation, namely the international investment dimension.<sup>8</sup> It would be unrealistic to expect that, in today’s world economy, trade facilitation alone would achieve the benefits that are being sought without investment facilitation. If anything, the interface of trade and investment calls for a close alignment of investment and trade policies.

A sustainable investment support programme could address a range of subjects, beginning with transparency:

- *Host countries* could commit to making comprehensive information promptly and easily available (online) to foreign investors on their laws, regulations and administrative practices directly bearing on *incoming* FDI, beginning with issues relating to the establishment of businesses and including any limitations and incentives that might exist. Information about investment opportunities, as well as help in project development, would also be desirable. Host country governments, be they of OECD or non-OECD economies, could also provide an opportunity for comments to interested stakeholders when changing the policy and regulatory framework directly bearing on FDI or when introducing new laws and regulations in this area; at the same time, they would of course retain ultimate decision-making power.
- *Multinational enterprises*, in turn, could make comprehensive information available on their corporate social responsibility programmes and any instruments they observe in the area of international investment, such as the ILO Tripartite Declaration and OECD Guidelines and the United Nations Global Compact.

- Both *host countries and MNEs* could commit to making investor-state contracts publicly available.
- From the perspective of investors, moreover, transparency is not only important as far as host countries are concerned, but also as regards support offered to outward investors by their *home countries*. Thus, home countries (through a designated focal point) could commit to making comprehensive information available to their foreign investors on the various measures they have in place, both to support and restrict *outgoing* FDI. Supportive home country measures include information services, financial and fiscal incentives and political risk insurance. Some of these measures are particularly important for small and medium-size enterprises.

On the national institutional side, IPAs, as one-stop shops, could be the focal points for matters related to a sustainable investment support programme, possibly coordinating with the national committees on trade facilitation to be established under the WTO's Trade Facilitation Agreement.<sup>91a</sup> Within a country's long-term development strategy, IPAs could undertake various activities to attract sustainable FDI and benefit from it as much as possible.<sup>91b</sup> They could, among other things:

- Improve the regulatory framework for investment by drawing lessons from best practices in countries that have successfully attracted sustainable FDI projects. Policy benchmarking could help in this respect.
- Establish time-limited and simplified procedures for obtaining permits, licenses etc., when feasible and when these do not limit the ability of governments to ensure that the regulatory procedures can be fully complied with by investors and government officials.
- Identify and eliminate unintended barriers to sustainable FDI flows.
- Engage in policy advocacy (part of which could relate to promoting the coherence of the investment and trade regulatory frameworks).
- Render after-investment services.
- Facilitate private-public partnerships.
- Identify opportunities for inserting the country in global value chains and targeting these.
- Promote backward and forward linkages between foreign investors and domestic firms.
- And—very importantly—find ways and means to increase the sustainable development impact of FDI in host countries.

Investment promotion agencies could also play a role in the development of investment risk-minimizing mechanisms badly needed to attract investment into, especially, various types of infrastructure. They could also have a role in the prevention and management of conflicts between investors and host countries (to be discussed below), including through providing information and advice regarding the implementation of applicable IIAs and the preparation of impact assessments to avoid that liability arises under these agreements. If conflicts arise, they could seek to resolve them before they reach the international arbitral level. Institutionalized

regular interactions between host country authorities and foreign (as well as domestic) investors would be of particular help in this respect. Finally, as in the WTO's Aid for Trade Initiative and the Trade Facilitation Agreement, donor countries could provide assistance and support for capacity building to developing countries (especially the least developed countries) in the implementation of the various elements of a sustainable investment support programme. This could begin with a holistic assessment of the various elements of the investment policy framework—economic determinants, FDI policy framework, investment promotion, related policies—and how it is anchored within the broader context of countries' overall development strategies. The Investment Policy Reviews undertaken by UNCTAD—or the WTO trade reviews or OECD investment reviews—could provide a useful tool that could be made available to more countries. Support could focus on strengthening the capacity of national IPAs as the country focal points for the implementation of the sustainable investment support programme and the central country institutions to attract FDI and increase its benefits.

The E15 Task Force on Investment Policy identified several ways in which a sustainable investment support programme could be taken forward:

- One option would be to extend the Aid for Trade Initiative to cover investment as well, and fully so (it has already been expanded to cover infrastructure and some elements of investment), creating an integrated platform for promoting sustainable FDI. This would be a logical and practical approach that recognizes the close interrelationship between investment and trade. It would also be in tune with already existing international frameworks such as the WTO's General Agreement on Trade in Services (as indicated earlier, transactions falling under Mode 3 of the GATS—"commercial presence"—account for nearly two-thirds of the world's FDI stock). The initial emphasis could thus be on investment in services, with a focus on sectors key to promoting sustainable development, such as environmental services, energy, transportation, and professional services. Alternatively, the current Aid for Trade Initiative could be complemented with a separate Aid for Investment Initiative; but, given the close linkages between trade and investment, this would be a second-best solution.
- Another, more ambitious, and medium-term option would be to expand the Trade Facilitation Agreement to cover sustainable investment as well, to become an Investment and Trade Facilitation Agreement. This could conceivably be done through an interpretation of that Agreement or through amending that Agreement; in either case, member states would have to agree. A subsidiary body of the Committee on Trade Facilitation (to be established in the WTO when the Trade Facilitation Agreement enters into force) could provide the platform to consult on any matters related to the operation of what would effectively be a sustainable investment module within the Trade Facilitation Agreement. Apart from such a module complementing the Trade Facilitation Agreement, such an approach could also build on the WTO's GATS and, more specifically, its commercial presence provisions.

- A third, and also ambitious, option is for all—or a group of interested—countries to launch a Sustainable Investment Facilitation Understanding that focuses entirely on practical ways to encourage the flow of sustainable FDI to developing countries. It could be inspired by, and complement, the Trade Facilitation Agreement. Work on such an Understanding could be undertaken, in due course, in the WTO. It could also begin within another international organization with experience in international investment matters, perhaps UNCTAD or the World Bank or the OECD.<sup>91c</sup> Or, a group of the leading outward FDI countries could launch such an initiative (which would, in effect, be a plurilateral approach); for instance, the top ten outward FDI economies (which include four non-OECD economies) accounted for four-fifths of world FDI outflows in 2014. The impetus could come from the G20, which could mandate the initiation of such work, should it be judged desirable to put such an Understanding in place.

### Establishing a Global Value Chain Partnership

The E15 Global Value Chain Expert Group has made proposals that could be combined in **a new international public-private platform to improve the efficiency and inclusiveness of global supply chains**. As described above at greater length in the *Reducing Commercial Friction and Investment Uncertainty* chapter, this platform would be aimed fundamentally at helping to increase practical cooperation between countries seeking to integrate their economies into international supply chains and the companies and experts who could be their partners. The action orientation of the partnership would be underpinned by important new analytical efforts to map existing value chains and impediments to their expansion in new geographies as well as to assemble evidence and examples of good practice that can inform countries of how to maximize the contribution to sustainable development of their participation in global and regional value chains. Specifically, the partnership could include:

- *Supply Chain Councils*. The private sector plays a key role in the operation of supply chains and there is a need for governments and policy-makers to better understand exactly how supply chains operate in practice. The creation of “supply chain councils” could serve this purpose, along the lines proposed by Hoekman (2013)<sup>92</sup>. These councils could focus on a selected number of specific production networks and would be composed of private sector firms, trade officials and regulators working within the sector in question.
- *Development Analysis*. Currently there is no platform gathering insights on how GVCs may offer a path to economic diversification and what type of developmental benefits might be gained from participating in these networks and under what conditions. This kind of information and analysis could aid developing country policy-makers in framing policies to be adopted at the national and regional levels, including trade and investment policies, which would assist the insertion and upgrading of their firms into global production networks.

- *Country Strategies and Capacity Building.* The value chain analytics, development expertise and opportunities for interaction of this platform would create a fertile environment for governments, firms and donor agencies providing support for capacity building requirements to explore opportunities for cooperation. Indeed, the platform could be a focal point for the development of a major new plank of Aid for Trade funding and technical assistance that is focused on helping countries strengthen institutional aspects of their enabling environments which are crucial to the effective functioning of value chains (e.g., services, investment, regulatory frameworks, customs and logistics, etc.). In addition to these ongoing activities of the platform, an annual forum or summit could be organized to take stock of progress, engage leaders and stimulate public-private dialogue aimed at drawing wider lessons from experiences around the world and identifying new strategic priorities.

### Expanding Services & SME Trade

A specific international effort to promote international trade in services and SME exports would also help to support economic diversification in middle-income countries. In particular, advances in information and communications technologies in recent years have opened up numerous opportunities for SMEs to engage in international commerce. Yet because these enterprises are small, they are disproportionately affected by trade costs associated with processes, procedures, regulations and other technical burdens associated with cross-border trade. Bearing in mind the new opportunities offered SMEs by the digitization of trade, the Expert Group on Services proposed the following actions:

- Call upon countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing and other administrative requirements;
- Recruit another international organization or an independent agency to rate and annually report on the progress of each country in this effort;
- Call upon countries implementing the Trade Facilitation Agreement to adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows;
- Encourage the establishment of online single windows for cross-border services providers in need of licenses, permits and other administrative requirements and explore the provision of Aid for Trade to implement this project in developing countries;
- Encourage the establishment of higher standardized *de minimis* customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers, especially SMEs.

## Improving Regulations & Standards

As countries build broad international linkages across the economy, the negative consequences of regulatory mismatches become more visible. Regulators have to consider the cross-border economic implications of their work, a responsibility that requires support though their legal mandates, the design of institutional mechanisms and a broader understanding of the impact of regulatory decisions on trade and investment incentives.<sup>93</sup> Similarly, as standards increasingly play a role in coordinating international production sharing, concerted efforts to improve the standards compliance capacity of firms and government agencies become stepping stones to competitiveness. Several E15 Expert Groups have made proposals to support the upgrading and international coherence of such important policy domains for economic diversification as competition, skills, innovation, subsidies and investment performance requirements. For example:

- **Develop human capital and allow the movement of skilled workers.** This includes increasing stocks of skill and expertise beyond the thresholds needed to achieve the momentum to escape the middle-income trap. High quality human capital is especially important for modern high value-added activities like business services, for adapting imported technology to local conditions and embodying it in exports with high local content.<sup>94</sup> One possibility identified by the Expert Group on Innovation would be to establish an innovation zone working through the General Agreement on Trade in Services (GATS) within which skilled researchers and technical personnel would be able to migrate freely.
- **Strengthen competition monitoring.** This proposal would provide a WTO mandate for competition agencies to evaluate, in consultation with external parties, their governments' anti-dumping actions, tariff schemes, procurement policies, sanitary and phytosanitary and technical barriers to trade regimes, foreign direct investment (FDI) review mechanisms, and services regulations, with ministerial-level authority to propose change. A Global Competition Alert, modelled on the Global Trade Alert, could be set up.
- **Establish competition best practices and cooperation.** This proposal would include consolidating informal international interactions between competition authorities, harnessing the OECD's technical capabilities and its own network to strengthen best practices, and developing a "model" advocacy strategy to help younger competition agencies persuade lawmakers to change existing laws to comply with best practices. With the help of UNCTAD, technical assistance and capacity building could be provided. Another recommendation is to update the WTO Telecoms Reference Paper to regulate competition that affects internet access and competition over the internet.
- **Soften and monitor local content requirements.** Local content requirements (LCRs) could be "softened" via broadening them to encompass inputs from regional economic communities – strengthening regional value chains in the process. As a complement, a WTO notification requirement for formal LCRs is recommended, to be captured in the trade-monitoring database, with regular

review via the Trade Policy Review Mechanism. Another recommendation is to improve understanding of the conditions required for LCRs to achieve the objective of generating positive spillovers for the local economy. WTO flexibilities for LCRs could be considered based on converting the WTO LCR prohibition into an “adverse effects” test, similar to the regulatory system for domestic subsidies.

- **Allow for non-actionable subsidies.** This involves explicitly allowing subsidies related to R&D, regional development, environmental protection and disaster recovery, by reviving a revised form of Article 8, and create a category of narrowly defined non-actionable subsidies with clear boundaries.
- **Update digital policies with private sector input.** This includes enhancing government/private sector cooperation on digital trade issues like dispute settlement, security and building awareness. The World Trade Organization (WTO) moratorium on customs duties on electronic transmissions could be made permanent. Other recommendations include empowering the WTO Work Programme on Electronic Commerce to further conceptualize how the digital economy can be supported in both developing and developed economies, and expanding the WTO’s information gathering and dissemination on digital trade through an external group of experts.
- **Facilitate learning and quality improvements.** This includes developing centres of excellence to build capabilities and foster synergies and joint ventures along value chains. Small and medium-sized enterprises could be trained to meet relevant product standards and follow process standards to improve cost and quality efficiency.<sup>95</sup> Creating and sharing databases of training programmes and experts would also be beneficial.<sup>96</sup>

## Conclusion

In summary, the search for diversification and competitiveness is best led through a combination of horizontal economic development policies and more targeted value-chain partnering. Each can be supported by domestic, regional and global actions.

E15 Expert Groups have outlined an agenda of measures that would help middle-income developing countries that wish to diversify their economies through an expansion of their share of the growing amount of foreign direct investment driven by global value chains and of trade in services and digitally-enabled SME exports. Such a concerted agenda by the international community would have the effect of increasing the payoff to these countries from implementing the kind of smart (mainly horizontal) domestic industrial policies used with considerable success by several East Asian and other economies over the past few decades. It would particularly aid small and medium-sized MICs that are unable to rely on the sheer size of their domestic market to attract the foreign capital, technology and know-how that can accelerate the upgrading and diversification of their economic base. Much of this agenda is facilitative rather than normative in nature, suggesting that it could be advanced organically over the next decade by purpose-built and results-oriented coalitions rather than through a formal WTO accord.



## Combating Climate Change and Environmental Degradation

Economic activity today remains dependent to a large extent on the natural environment, and its possibilities and success in generating higher levels of well-being are intimately linked to the integrity of energy systems in nature, well-functioning ecosystems and the sustainability of resources. International trade and investment frameworks regulating the global economy, together with a myriad of specific legal treaties and agreements for international cooperation, determine directly or indirectly the use and allocation of resources in any national economy. Currently, the world faces critical environmental and natural resource challenges, particularly related to climate change emanating from anthropogenic activity, water stress, desertification and soil atrophy, diminishing fisheries and biodiversity, timber harvesting and the exploitation of extractive resources. Other stresses are related to the pollution of water, air and soils.

The interaction of trade with each of these problems is very specific but multifaceted. In many instances it's localized geographically, in others the problems are global in nature as they concern global commons or migratory species. On several occasions the international community has reiterated the primacy of adequate stewardship of the natural environment over economic activity. It did so recently in the adoption of the Agenda 2030 for Sustainable Development and its Sustainable Development Goals, where the coherence between trade and investment policies and the natural environment is called for as a means to address poverty.

In the context of the E15 Initiative, four main clusters of issues related to this vast agenda were treated: climate change and clean energy technologies; extractive industries; fisheries and oceans; and challenges related to environmental policy more generally. Recognizing that the topic is larger than these four clusters, this chapter will focus on them in the context of global governance options for trade and investment.

### Climate Change in Today's Globalized Economy

Climate change presents several challenges directly relevant to trade policy and regulatory systems:

- The biophysical impacts of climate change will directly impact sourcing, land use, as well as production and trade flows and, most likely, terms of trade and competitiveness. It seems certain that agriculture will be altered by changed weather patterns, shifts of crops and herds, and changed methods of production. The geography of production and trade flows of food, fibre and biofuels are expected to dramatically change in the next 10 years.
- Moves to promote mitigation and adaptation, including national and subnational policy strategies, will imply major transformations to consumption and production patterns, and consequently for trade.

The challenge for climate and trade policy is to steer a transition of this magnitude without compromising development and growth prospects. Cooperative international action, such as through the United Nations Framework Convention on Climate Change (UNFCCC), is crucial to managing the impacts on competitiveness in an equitable manner.

Over the past 20 years, the relationship between multilateral policy-making on climate and trade has been characterized by avoidance rather than collaboration. The climate regime, unlike some other environmental agreements, has so far avoided the use of trade measures to implement its objectives. But the obvious links, coupled with the politics of climate discussions, seem to be pushing for convergence.

**The Paris Agreement: a high ambition global accord to address climate change, through differentiated capabilities and bottom-up contributions.**

In December 2015, parties to the UNFCCC delivered a new climate agreement applicable to all. Rather than a comprehensive binding top-down agreement, prescribing national policies and measures, the deal is based on bottom-up *contributions* by individual countries, so-called Nationally Determined Contributions (NDCs). This provides countries with much leeway to target climate policies to their respective circumstances, needs and capacities. It also elevates ambition, with a new best-endeavour temperature limit outlined as part of the “purpose” of the agreement. Although parties reaffirm previously-agreed intentions to hold global average temperatures well below a two-degree-Celsius rise from pre-industrial levels, they would also pursue best efforts to limit these to 1.5 degrees Celsius.

In addition, subnational and non-state actors, such as cities, regions, companies and investors, will play an increasing and more formalized role in the climate effort. It's now recognized that, operating at multiple scales and arrangements, including transnational, and under often more enabling mandates than national governments, these actors can realize mitigation efforts that may complement or be more difficult to achieve at the national and multilateral levels. For example, while implementing national carbon pricing in the United States has so far proved unsuccessful, several subfederal entities, such as California and those states that take part in the Regional Greenhouse Gas Initiative (RGGI), have implemented emissions trading schemes (ETSs) in territories under their jurisdiction. In addition, many companies use shadow carbon pricing in their business decisions, even where actual carbon prices do not exist or are very low.

**Monitoring, reporting, verification and compliance: top-down elements of climate governance.** An implication of the bottom-up approach is, however, that the level and nature of contributions will vary between countries. This raises a range of challenges, for example with regard to the aggregate effect of the individual contributions and compliance. One key role of the UNFCCC will therefore lie in providing and operating a robust framework for the monitoring, reporting and verification of contributions. In doing so, it can complement the bottom-

up approach with some crucial top-down elements of climate governance. The Paris Agreement includes a *carbon budget* by noting with concern that current efforts do not fall within least-cost two-degree-Celsius scenarios, and that much greater efforts will be needed to reduce emissions to 40 Gt by 2030 from a current projected level of 55 Gt. To remedy this situation, a five-year review cycle of the NDCs submitted was created, and new national plans call for a manner that would incrementally ratchet compromises. The new INDC submissions should be informed by a global stocktake designed to assess progress towards achieving the deal's delivery on its long-term goals. A first review will take place in 2023 and thereafter every five years.

This Paris Agreement is a major undertaking with transformative aims affecting sourcing, production, trade and the consumption of goods and services in the global economy. Its explicit aspiration to neutralize carbon emissions by 2050 in the entire global economy supposes either a full phaseout of fossil fuels or an augmentation of sink capacity through either the introduction of technologies to capture and store carbon, or the enhanced capacity of natural sinks such as forests and oceans. Such an outcome would only be possible through a major transformation of energy supply for electricity and mobility. In turn the required massive scale-up of clean energy technologies would only be feasible in a policy environment that stimulates rapid technological development and the markets for investment, goods, services and associated knowledge, while discouraging and penalizing the use of fossil fuels.

With the burden of **implementing the Paris Agreement falling on national policies and measures** pledged under the aegis of tackling climate change or adaptation, potential conflicts may arise with frameworks regulating trade and investment at the various international levels; similarly, one risk is that climate-related actions end up being judged by the World Trade Organization's (WTO) Dispute Settlement Body, when and if such policies and measures result in discrimination or are deemed to constitute disguise protectionism. It may therefore be necessary to create some clarity and space for climate measures under the multilateral trading system, for example through waivers of WTO obligations or interpretative understandings of WTO rules.<sup>96a</sup>

Against this backdrop, the E15 Initiative identified a large number of policy options for the global trade and investment system to respond to the challenge posed by climate change by:

- Ensuring coherence between the trade and climate regimes;
- Contributing to climate action through enabling trade and investment frameworks;
- Enabling the transition to low-carbon energy systems.

Some of these options are summarized below.

## Coherence between Regimes

- Coherence will only be fully achieved once parties of both the UNFCCC and the WTO develop a system for the **systematic assessment of mutual implications**, for instance by accordingly expanding the mandates of the WTO's Committee on Trade and Environment and the Trade Policy Review Mechanism, on one hand, and a UNFCCC subsidiary scientific body on the other.
- Through common action, agreement on a **clear definition of what constitutes “climate measures” and/or “climate action”** is needed for the purposes of dispute settlement under trade regimes. In this same vein, a legal breathing space could be established in the WTO through a **time-limited “peace clause”** on challenges to such measures or actions.
- The establishment of a **dispute settlement mechanism (DSM) under the UNFCCC** could be promoted along with agreement to bind the WTO for purposes of dispute settlement to judgements of such climate DSM to allow for the furtherance of national determined contributions.
- To make viable sectoral approaches to climate action related to emissions in international maritime shipping and international aviation, it may be necessary to **decide at the WTO that climate agreements affecting trade established under the International Maritime Organization and International Civil Aviation Organization will be upheld in WTO** dispute settlements for WTO members that are parties to those agreements.

## Enabling Trade and Investment Frameworks

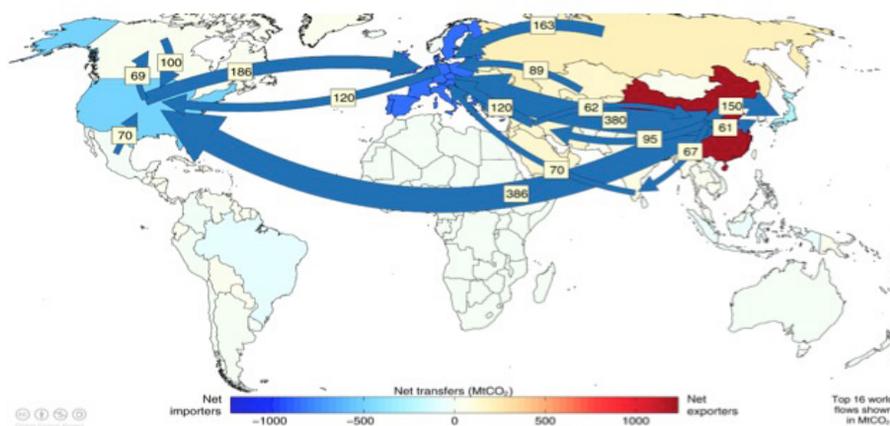
- Differentiation between and among traded goods on the basis of carbon use and carbon emissions would need the **establishment of international standards for carbon accounting**, as well as a **“waiver” from WTO obligations** for all trade restrictive “climate measures” based on embedded carbon and taken in furtherance of and in compliance with the UNFCCC agreements.
- **Plurilateral implementation of the UNFCCC Paris Agreement** may be desirable through higher ambition club-type agreements between several parties. One such *climate pricing club* was launched in Paris. These arrangements may include subnational jurisdictions with competence to impose climate measures, such as provinces. To ensure the viability of clubs incorporating the use of trade-related climate measures under WTO law, **climate clubs may be established within regional trade agreements (RTAs)**. Otherwise, it may be necessary for **WTO members to affirm through a decision the permissibility to provide WTO-plus benefits among club members or to discriminate against non-members**.
- According to a 2014 World Bank report, 39 national and 23 subnational jurisdictions have implemented or are scheduled to implement *carbon pricing* instruments,<sup>96b</sup> such as ETS or carbon taxes, in an effort to reduce GHG emissions. However, the uncoordinated implementation of such approaches and unilateral carbon pricing are often accompanied by concerns about carbon leakage, as well as competitiveness concerns from trade-exposed

domestic industries. To deal with these concerns, many jurisdictions have chosen to reduce the carbon costs for their affected industries. For example, in ETSs large shares of allowances are often allocated for free. Another option may be the use of *border adjustment measures*. Agreements to cooperate on carbon pricing could also alleviate competitiveness and carbon leakage concerns and provide an alternative to the above measures. With 19 existing ETSs and 11 more under consideration, including a national ETS to enter into force at a national level in China in 2017, the linking of schemes with each other is expected to become a trend as it would lead to a convergence of carbon prices in addition to providing other benefits, such as increased market liquidity as well as greater price stability and predictability. Enabling the further development of these possibilities would require a **clarification of exemptions in WTO's Article XX such that they apply to the protection of the world's climate**. With respect to taxes, it may be necessary to **adopt a decision by WTO members providing that a carbon tax is an indirect tax under Article II:2(a) of the General Agreement on Tariffs and Trade (GATT)** and not a violation of Article III:2 on excessive taxation.

- **Climate provisions in regional trade agreements and international investment agreements:** There is significant space for regional trade agreements (RTAs) and international investment agreements (IIAs) to drive climate action through the inclusion of climate measures. Since such agreements involve smaller groups of countries, they provide opportunities to take on more ambitious climate actions than those conceivable at a multilateral level. At the same time, they can reduce some concerns associated with unilateral action. RTAs can create windows for climate action through the adoption of exemptions from trade rules that could otherwise restrict climate measures. RTAs and IIAs can also include commitments not to lower climate standards to attract foreign investment, so as to avoid a “race to the bottom”. Another concrete opportunity for RTAs is to adopt specific provisions for deeper cooperation on climate change issues among signatories, for example in the area of carbon markets or technology transfer. RTAs also have the potential to promote the scale-up of trade in environmental goods and services, for example through the inclusion of relevant liberalization provisions, possibly going beyond tariffs to encompass non-tariff barriers (NTBs).<sup>96c</sup>
- **Carbon and international trade: dealing with territorial versus consumption-based emissions.** The current design of policies and measures to address climate issues, including most of those listed by countries in their INDCs under the UNFCCC, largely target the production level. This is in line with the current accounting framework, as greenhouse gas (GHG) emissions are attributed to the countries in which they occur during the production process. However, this approach fails to take into account imports and exports of embedded carbon in goods and services traded internationally, which account for almost one-fourth of global emissions.<sup>96d</sup> In fact, based on 2012 data, many developed economies are net importers of embodied carbon emissions, while others are net exporters.<sup>96e</sup> This means that although some countries have reduced their territorial emissions, they have in some cases increased them at the consumption level. As a result, in some countries total emissions remain unchanged or have even increased.

There are therefore potential gains from complementing production-based approaches through consumption-based accounting and policies. It can help address carbon embedded in international trade and thus drive greater and more effective climate mitigation at the global level. At the same time, it would help address consumption as a key driver of increasing GHG emissions by offering a wider range of mitigation options across the value chain and at the point of final consumption.

However, in addition to challenges in accurately accounting for consumption-based emissions, policies targeting the consumption level will have different implications for international trade. An array of policies could be designed to address consumption-based emissions, ranging from technical regulations, private standards and labelling, to carbon embodied taxes, waste targets and infrastructure improvements. From a trade perspective, some of these may be covered in the options provided above. Still, while any successful consumption-based policy will affect international trade flows due to the demand changes it induces, some policies may lead to more direct impacts, such as market access barriers, and would require the kind of WTO dispensation identified above for embedded carbon to ensure their compatibility.



Source: Davis, S.J. and Caldeira, K., “Consumption-based accounting of CO<sub>2</sub> emissions”, *Proceedings of the National Academy of Sciences of the United States of America* (2010), 107(12): 5687-5692.

Note: dominant net exporting countries of emissions (blue) and dominant net importing countries of emissions (red)

## Enabling the Energy Transition

- A transition to cleaner energy will require a prompt full costing of fossil fuels. A first step is the **elimination of fossil fuel subsidies**. Since such practices affect competition and trade, the WTO rulebook could be of immediate help if a full **disclosure of fossil fuel subsidies is mandated, and they are positively identified as actionable, and gradually prohibited** in time. In addition, through fisheries subsidies reform, the elimination of fossil fuels used in fisheries fleets, which may account for over 1% of global fuel consumption, could be pursued.
- The massive scale-up of clean energy technologies (CET) in a globalized economy characterized by international supply chains would require ensuring the most efficient provision of parts and services for CET installations. **Tariff liberalization** has been proposed as an immediate option to be pursued through ongoing Environmental Goods Agreement (EGA) negotiations within the WTO, through RTAs, via a comprehensive Sustainable Energy Trade Agreement or through unilateral action.<sup>96f</sup> The EGA is organized as a critical mass plurilateral that would extend benefits to all 163 WTO members. In order for the ensuing agreement to become truly relevant for climate mitigation purposes, it would seem necessary to significantly increase the coverage of goods. In particular, it would be necessary to include components, such as inverters used in solar PV systems and ball and needle bearings used in wind turbines. In addition, CET technologies are often made of components that contain embedded services (such as software activated devices) or require associated services to make them useful. The initial focus of the EGA is only on tariffs for goods, and the challenge will be to **extend the agreement to services and NTBs** in order to reap greater climate benefits.
- Market access is also affected in a major way by the imposition of additional duties on imports deemed to be sold at dumping prices. Indeed, the targeting of CETs seems to be a recent trend.<sup>96g</sup> Options have been identified to address this problem by i) targeting anticompetitive behaviour rather than simple price discrimination – **use antitrust law**; ii) **limit trade remedies on CET** in level, time, number and value of imports; iii) include in antidumping investigations on CET a public interest test, and environmental provisions in the WTO's Anti-Dumping Agreement (AD) and **make climate change a criterion in public interest tests**.
- To date, a range of national and subnational jurisdictions have implemented trade-related measures aimed at increasing the generation of clean energy and the deployment of energy efficiency goods and services. Renewable energy subsidies intended to promote the production and consumption of clean energy are a popular example. However, as subsidies can be trade-distorting or used to protect domestic industry, their use is disciplined by the WTO's Agreement on Subsidies and Countervailing Measures (SCMs). Whether a climate-related subsidy can be successfully challenged depends upon its trade effects vis-à-vis other WTO members. When subsidies involve local content requirements (LCRs), there is a particular risk for them to be challenged under the WTO – as evidenced by existing disputes<sup>96h</sup> – as they have a stronger likelihood of being disguised trade restrictions.

Since the transition to a low-carbon economy will require large-scale transformative actions, which implies substantive investments into new technologies, it raises the question of whether there is a need to create additional policy space for climate-related subsidies. Put simply, certain subsidies might be desirable in light of the climate challenge despite potential market-distorting effects and may require different rules from those currently in place. One option would be **to extend GATT Article XX on General Exceptions to subsidies**, as there is no equivalent to this in the WTO's Agreement on Subsidies and Countervailing Measures Agreement (SCM).<sup>96i</sup> Another possibility would be to **create a permanent exception under the SCM Agreement**. A **clean energy waiver** could also create some policy space for clean energy subsidies.<sup>96j</sup>

- CETs require a number of services to be assembled, installed, operated and maintained. These are often provided through the various modes of supply, i.e. cross-border services, through the establishment of services providers in the country of installation, or through the cross-border movement of service providers. In this context, it is necessary to undertake a scoping exercise to clarify which **services** closely support CETs and to incorporate them into a plurilateral agreement such as the EGA, or in individual schedules of liberalization under trade in services frameworks, such as the GATS.
- Use of CETs may not be possible in certain jurisdictions, given natural conditions (availability of sun, wind, geothermal, etc.). In this context, electricity import through interconnected grids would be required. **A clarification of the classification of electricity as either a good or a service**, as well as of rules governing the transport of electricity across borders is proposed as neither is explicitly dealt with in the WTO.

## Natural Resources — Extractives

Non-renewable mineral resources dominate the economies of over half of the world's countries, which collectively account for a quarter of the world's GDP. Many of these are poor low and middle economies, such as those in Africa, home to 30% of the world's mineral reserves. If managed properly, natural resource endowment has an important potential for contributing to sustainable development goals and targets.

Natural resources are heavily traded. Between 1998 and 2008 world exports increased more than six-fold, albeit in large part due to steadily rising prices. According to the 2013 World Energy Outlook,<sup>96k</sup> fossil fuels including crude oil, coal and gas will remain the major source of energy generation throughout the next decade, with use increasing by one-third from 2011 to 2035. Nearly two-thirds of oil production and one third of natural gas is traded each year. There is potential for high growth, especially with regard to trade in liquefied natural gas (LNG). The share of mining products in global exports is relatively smaller, but mining products dominate exports in a number of developing countries

Although international trade is indispensable for the economic viability of mining, research has mostly concentrated on oil or export restrictions – both taxes and quantitative limits. International investment law and policy have been concerned with protecting the foreign investor in resource rich countries but there are now calls for a more balanced approach, enabling host countries to pursue public policy objectives.

The sense that underground riches have contributed insufficiently into societal value and durable development outcomes, has led to governments to try a wide variety of policy interventions, including industrial policies, export restrictions, local content requirements, and provision of competitive advantages to state-owned enterprises, with mixed results. Now that the most recent commodity price boom seems to be over and FDI in extractives is contracting, resource-rich countries are even more concerned about building linkages upstream and downstream to reduce their vulnerability to price volatility by ensuring that the extractives industry is integrated in the wider economy.

The E15 Expert Group on trade and investment in extractives focused on three overarching objectives that international trade and investment frameworks should support:

- Sustainable extraction of natural resources
- Distribution of benefits and contribution to economic transformation of host countries
- Access and availability on global markets

The main options proposed to ensure that the trade and investment regime supports such objectives include:

- Negotiate, multilaterally or plurilaterally, improvements in investment agreements related to the extractives industry. Some of the greatest challenges faced by FDI in natural resources include lack of transparency in revenue streams, controls to prevent corruption, and measures to set and enforce effective environmental standards.
- **Develop a sectoral agreement on finite natural resources and trade:** The sector exhibits sufficient specificities for a stand-alone agreement to be valuable (as exists for agriculture) This would help to structure regulations to reflect the particularities of the extractives sector (finite resources, environmental concerns, rights of indigenous communities, etc.) which are often overlooked in general agreements. Such an approach would contain disciplines, including on local content, which would take into account the needs of governments to diversify given the finite nature of resources.

## Fisheries and Oceans

Global marine fish stocks have been unsustainably exploited for decades. Despite efforts at national and collective fisheries management, the Food and Agriculture Organization of the United Nations (FAO) reports that in 2011, 28.8% of assessed marine fish stocks were fished beyond biologically sustainable levels, while 61.3% were fished at maximum sustainable level and only 9.9% of stocks were under-fished. Over-exploited, and therefore under-productive, stocks represent an ongoing loss to the global economy. The FAO estimates that returning overfished stocks to healthy levels could result in an additional 16.5 million tonnes of catch per year, and boost annual rents from fisheries by \$32 billion. While global marine capture production has not increased appreciably in the last 25 years, production of fish from aquaculture more than tripled, from 13.4% of production in 1990 to 42.2% in 2012. (FAO, 2014)

A significant proportion of fish products are traded, exposing fisheries harvesting and production decisions to global demand and supply. In 2012, 37% of global fish production, with a total value of just over \$129 billion, was exported, over half of this value originated in developing countries. (FAO, 2014) China and Thailand, for example, are important processing locations for fish sold in the United States and in Europe. While the direct impact of traditional trade policy measures (like tariffs) on the sustainability of exploited fish stocks appears to be context-specific, there is evidence that some tariff policies (particularly tariff preferences for low-income countries) have shaped patterns of fish processing and trade in fish products. (Campling, 2015)

**Fisheries subsidies:** WWF estimates that the global fisheries fleet is 2 to 3 times larger than what the oceans can sustainably support. There is strong evidence that the billions of dollars' worth of subsidies provided to the fishing industry contribute to over-capacity in fishing fleets and overfishing of fish stocks. The lack of transparency around the amounts of money provided by governments to their fishing sectors means that many global studies of subsidy levels are essentially estimates. The most comprehensive recent global estimate (Sumaila et al., 2013) suggests that governments provided around \$35 billion in fishing subsidies in 2009. Japan, China, the European Union and the United States were among the largest subsidisers.

Not all transfers to the fishing industry necessarily have a negative impact on fish stocks. Sumaila et al.'s estimate classifies subsidies into those that are:

- beneficial, in the sense that they encourage investment in the resource (e.g. fisheries management expenditure);
- capacity-enhancing subsidies that encourage dis-investment in the resource once fishing effort exceeds what would be economically rational (e.g. subsidies to vessel construction or to fuel);
- those subsidies whose effects on fish stocks are ambiguous (e.g. subsidies to buy back fishing vessels).

According to Sumaila et al.'s estimates, capacity-enhancing subsidies accounted for \$20 billion in 2009. The single largest kind of subsidy was subsidies to fuel, which accounted for 22% of the total, or around \$7.7 billion in 2009.

**Illegal, Unreported and Unregulated (IUU) fishing:** Another major challenge for sustainable fisheries is the prevalence of IUU fishing. Estimates suggest that between 11 million and 26 million tonnes of fish, with a value of between \$10 billion and \$23.5 billion, is lost to illegal and unreported fishing every year. (Agnew et al. 2009). The same study found that illegal and unreported fishing is particularly prevalent in seas where governance is poor, and that developing countries were at particular risk; total estimated catch off the coasts of West Africa, for example, was 40% higher than the level of catch reported. The role of large import markets is significant: between 20 and 35% (by weight) of all wild-caught seafood imported into the United States in 2011 is estimated to be from illegal and unreported catch. (Pramod et al., 2014) According to European Commission estimates, around €1.1 billion worth of illegally caught fish from foreign-flagged vessels enters the European market every year (EC, 2007).

### **Addressing Root Causes of Fisheries Depletion through the Trade Regime**

- Concern over the environmental and commercial impact of subsidies led to a mandate for negotiations to discipline fisheries subsidies as part of the 2001 Doha Development Agenda (DDA) of the World Trade Organization (WTO). The reliance of much industrial fishing on subsidies also meant that negotiations over subsidies became, in a sense, proxy negotiations over access to the resource itself. In this context, the discussions revealed fundamental disagreement between existing and emerging fishing powers over their respective roles in global fishing. In this context it is urgent to **establish multilateral disciplines in fisheries subsidies** through the mandated negotiations of the WTO Doha Round. Failing that, do so by **building step-wise and bottom-up based on a the plurilateral provisions agreed in the context of the Trans Pacific Partnership Agreement (TPP)**. Parallel to the DDA negotiations, twelve WTO members have agreed to their own system of disciplines on fisheries subsidies as part of the Trans-Pacific Partnership Agreement (TPP), still to be ratified at the time of writing. (USTR, 2015) In the mercantilist arithmetic that generally governs trade negotiations, it was generally assumed that subsidy reform could only be tackled multilaterally; otherwise those outside the agreement would free-ride on the benefits of reform by those that were subject to the deal. The development of meaningful plurilateral disciplines on fisheries subsidies is therefore be very significant. It indicates that, for the countries participating, the benefits of being part of the TPP deal (either in terms of market access or the kudos of leading by example) are worth the cost of reform, including its benefits to free riders outside the deal. Disciplines on fisheries subsidies are also under discussion in the TTIP agreement (NOAA 2015).

- **Establish effective measures to address IUU.** Large import markets appear to be leading the way in using trade measures to address IUU fishing. The European Union’s IUU fishing regulation, which entered into force in 2010, establishes requirements, building on catch documentation, for imports of fish into the community. The measure has already resulted in sanctions on fisheries imports being imposed on Cambodia, Belize, Guinea and Sri Lanka and improvements in fisheries governance in other target countries (EC 2015). The Action Plan of the Presidential Task Force on IUU Fishing indicates the United States will pursue both cooperative and unilateral measures, including around the traceability of fish products, in an effort to reduce the amount of illegal imports.
- **Build from the plurilateral disciplines on subsidies agreed in the TPP.** TPP established a prohibition of subsidies to fishing that harms overfished stocks (with stock status determined by a national government, Regional Fisheries Management Organization (RFMO), or “best scientific evidence available”) and a prohibition of subsidies to vessels engaged in IUU fishing (as listed by flag states or RFMOs). Very similar prohibitions have been tabled in the WTO negotiations in the last few months, but the scope of the TPP prohibitions is narrower and arguably subject to greater Party control than what is being proposed in the WTO. There is also an obligation to phase out these subsidies within 3 years (2 extra for Viet Nam) and a ‘best endeavours’ stand-still on other harmful subsidies. Additionally, there is an obligation to notify fishery subsidies, including information about the fish stock and capacity in the fishery for which the subsidy is provided.
- Establish **a cooperative networking of unilateral IUU trade schemes**, to support cooperative approaches. As large fisheries markets take the lead in addressing trade in IUU fish, **strengthening and linking these unilateral measures, through trade agreements** or otherwise, could help to gradually close off the global market for illegally caught fish. Furthermore, **create a network of regional measures** to address IUU fish trade, linking mutual recognition systems for standards applicable to fish products.
- Support expansion of private sector scheme and ensure coherence between private standards and TBT Code.

### Other Environmental Challenges

As the supporting governance body for global trade, and the source of most of its principles and fundamental norms, the WTO and its dispute settlement system have often been called upon to define, case by case, the balance between the benefits of fair and open trade with the imperative of environmental protection. Put very briefly, the WTO’s foundation system, drawn from the GATT is based on two overarching principles: transparent and predictable trade openness; and non-discrimination between similar (or “like”) products whether imported or domestically produced. WTO Members commit not to impose new quantitative restrictions on traded products and are required to file, and abide by, schedules of commitments to market access for goods and services. They are also required to provide the same “national treatment” to imported as to “like” domestic goods and the same “most-favoured-nation” treatment to goods or services regardless of origin.

There are several qualified exceptions to these basic rules, including better treatment (e.g. lower tariffs) negotiated under RTAs and exceptions for measures taken to meet other policy objectives, including, under GATT Article XX b) and g), measures “necessary to protect human, animal or plant life or health” and those “relating to the conservation of exhaustible natural resources”. To avail themselves of these exceptions, measures must meet the requirements of the chapeau of Article XX, including not being applied so as to create “arbitrary or unjustifiable discrimination” between WTO Members, or being a “disguised restriction on international trade”. The evolving WTO jurisprudence around GATT Article XX suggests that while governments retain the right to use trade-restrictive measures to protect the environment, they must design and implement measures carefully. For example, to fit under Article XX b) a trade measure must be “necessary” in the sense that it: i) is suitable for the policy objective; ii) is the least-trade-restrictive measure reasonably available to meet that objective, and iii) passes what some might call a proportionality test, judged by weighing the measure’s contribution to the policy objective, its trade-restrictiveness, and the importance of the policy objective itself (see Cottier et al., 2012).

As tariffs, particularly in developed countries, have fallen, WTO Members have increasingly turned to non-tariff measures to address environmental objectives. The WTO Agreement on Technical Barriers to Trade (TBT) governs the use of technical regulations (with which compliance is mandatory) and standards (with which compliance is not mandatory). Technical regulations may be imposed to pursue a legitimate policy objective, but must be no more trade restrictive than necessary to achieve that objective. A suite of recent cases about the TBT Agreement has provided some clarification about the agreement’s standards. In particular, technical regulations should treat domestic and imported products “even-handedly” and be “calibrated” to address different levels of risk presented by different products (see for example the Appellate Body Report in *US-Tuna II*, WT/DS381/AB/R of 16 May 2012).

Regional trade and investment agreements, often the fora for experimentation in trade rules, increasingly include provisions relating to the protection of the environment (Gehring et al., 2013). In many agreements these provisions establish exceptions, similar to GATT Article XX, for environmental measures or provide for cooperation around environmental issues. More recent agreements, particularly those involving the United States and the European Union, include commitments not to weaken environmental standards in ways that affect trade and investment, or to address particular environmental issues. The US-Peru Trade Promotion Agreement, for example, includes an Annex on Forest Sector Governance containing substantial obligations that are being implemented progressively to improve Peru’s forest governance and address illegal timber trade. (USTR).

## Conclusion

The transition to a prosperous, low-carbon economy will be part and parcel of the broader shift to a sustainable, resource-efficient and green economy. A transformation of such magnitude requires an active adaptation of policies concerning all economic activity, from agriculture to manufacturing and services. Towards this end, efforts and policy tools have been creatively devised and successfully introduced over the past 20 years, including fees, taxes, standards, certification and behaviour-shifting incentives. Still, the scale of change achieved thus far is suboptimal, and worthy schemes such as those concerning fair trade, fisheries or timber – even though highly sophisticated – continue to reach only a modest, segment of global or domestic markets. In the future, sustainable trade policies will need to reach a level that triggers full-fledged market transformation. This is where trade and investment frameworks can do the job.

## Ensuring Food Security

Ensuring that food is available, accessible and affordable to all is a primary challenge for any society.<sup>97</sup> In a world of heterogeneous agro-ecological conditions and economic and technological capabilities, some countries are able to produce their domestic food requirements to satisfaction, while others simply cannot, which is a fundamental reason why a reliable international market for food is needed. Moreover, the expected impacts from global warming and climatic disruptions, as well as water stress and changing demographics, dictate that the current regulatory frameworks must be adapted over the next 15 years to make them conducive to governance during rapid and massive changes in supply, demand and the ways in which food production and trade are organized.

Indeed, global agricultural markets have evolved significantly since the turn of the century. In the last 15 years, global agricultural trade flows, excluding trade between European Union (EU) Member States, have grown almost threefold to reach \$1 trillion.<sup>98</sup> This trend is likely to continue in the next few decades as income and urban populations grow, which is often accompanied by changes in diet. By 2020, estimates show the middle class will reach 2.8 billion people, compared to about 1.8 billion in 2010, with most of that growth originating in emerging economies.<sup>99</sup> Developing countries' markets now represent a significant portion of agricultural trade and an overwhelming share of its growth. Developing countries (least developed countries excluded) account for more than 40% of world imports compared to 26% in 2000, and for over 45% of world exports compared to 34% in 2000.<sup>100</sup> In the years ahead, the greatest demand will come from Asia, where a trade deficit is expected in all commodities except rice, vegetable oils and fish in 2023. In Africa, a rapidly growing population will also result in increased food imports.<sup>101</sup>

These forecasts confirm the critical contribution of trade as a builder of bridges between food surplus and food deficit countries. They also suggest growth in trade flows – particularly imports – in emerging economies, regardless of market access conditions. At the same time, the “Agricultural Outlook 2015-2024” of the Organisation for Economic Co-operation and Development (OECD) and the Food and Agriculture Organization of the United Nations (FAO) predicts that exports of agricultural commodities will become more concentrated among fewer countries, whereas imports will spread over a large number of countries. This increased reliance on relatively few countries to supply global markets with certain key commodities will result in higher market risks, including those associated with natural disasters or the adoption of disruptive trade measures.

Beyond these changes in trade flows, five main trends have characterized the global agricultural system in recent years:

- The emergence of a new normal in agricultural prices. Historically, markets have been characterized by abundant supplies exerting downward pressure on food prices and, ultimately, farm incomes. As a response, policy-makers, particularly in OECD countries, had recourse to various forms of support, such as income and price support and other forms of subsidies often combined with prohibitive tariff barriers on sensitive commodities. These measures induced surpluses that had to be disposed of in international markets, often with the help of export subsidies, whose effect contributed to further lowering world prices and providing disincentives to invest in agriculture in developing countries, ultimately affecting the livelihoods of small farmers and food security.<sup>102</sup> Between 2008 and 2011, however, several agricultural commodities experienced significant price spikes, reflecting the immediate impact of weather-related production shortfalls, against a backdrop of high energy prices, the increased use of crops for the production of biofuels, and low rates of productivity growth in many world regions. The extent to which these events mark a permanent transition towards higher prices, reflecting changes in demand patterns, remains hotly debated, however, particularly in light of recent price declines for several commodities and fossil fuel.<sup>103</sup>
- Extreme price volatility and insulating policies that erode confidence in global markets. The 2008-2011 price spikes were largely exacerbated by insulating trade policy measures, such as export restrictions or the removal of tariff protection, fuelling volatility on global markets and directly affecting low-income food deficit countries.<sup>104</sup> As food import bills increased, confidence in global markets as reliable sources of affordable food diminished, and attention turned to support for domestic food production in an attempt to enhance self-sufficiency.<sup>105</sup>
- Climate change as a factor influencing production and trade. The biophysical impacts of climate change, including long-term changes in temperatures and precipitation and the increased likelihood of extreme weather events, will further alter crop and livestock productivity and, ultimately, the geography and intensity of trade flows. The best models available predict major disruptions in agriculture caused by climate in four subregions of Asia and the African continent, precisely where rapid population growth is expected to concentrate in the next three decades. Many countries, already net food importers, will see their food bills surge, and several food exporters are expected to lose their ability to grow food.<sup>106</sup> Assessing the scope and magnitude of these changes is challenging but, overall, international trade is likely to play an increased role in offsetting climate-induced production shortfalls in certain regions and making food available in countries that cannot produce it themselves.<sup>107</sup>

- The resurgence of domestic support. In the absence of coordinated action at the World Trade Organization (WTO), nationally focused agricultural policies have taken the lead in shaping land use, production patterns and, ultimately, international trade flows. Responding to the rapidly changing environment, large producing and consuming countries are reforming their agricultural policies, exploring new instruments. Such national policies often pursue critical systemic objectives, such as food security, poverty reduction or environmental sustainability. However, they remain largely informed by domestic interests, and their potential negative spillover effects on other countries are often considered as an afterthought. For example, emerging economies such as India or China have massively increased their support to agriculture, in an attempt to boost domestic production, raise rural incomes and tackle food insecurity. They provide support through diverse approaches and with different policy objectives. Domestic policies in developed countries have also evolved, but overall the shift towards less trade-distorting support initiated by previous reforms has slowed down or even reversed.<sup>108</sup>
  
- The proliferation of regional trade agreements. Regional trade agreements (RTAs) have proliferated over the last few decades. Concerning agriculture, RTAs mostly focused on market access and, while sensitive products are often excluded from RTA coverage, Bureau and Jean (2013) estimate that, on average, RTAs increase agricultural and food exports between signatories by 32% to 48% when fully phased in. Ongoing negotiations, notably under the so-called mega-regional trade agreements, are likely to result in further market opening. The three largest “mega” initiatives – the Transatlantic Trade and Investment Partnership (TTIP), the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) in Asia and the Pacific – currently involve 49 countries and represent over three-quarters of global GDP and two-thirds of world trade. While some of these negotiations have not yet concluded, the initial ambitions are certainly high. As such, these initiatives are likely to define the roadmap for trade regulation regimes of the future, with results that involve deeper integration and WTO-plus disciplines or liberalization. However, these agreements essentially focus on reducing tariff and non-tariff barriers and have generally failed to address agricultural subsidies, highlighting the need for action at the multilateral level.

These new trends and associated policy changes have revealed critical loopholes in international economic governance frameworks. While some could be addressed through ongoing negotiations in the WTO, others would require new disciplines or action outside of the multilateral trading system. The proposals developed by the E15 Expert Groups in this area aim at addressing both old and new challenges in agricultural trade from a food security perspective.

Four sets of proposals developed by E15 Expert Groups have particularly strong potential to respond to these new food security challenges over the next 10 years by:

- Establishing an equitable and predictable multilateral trade system;
- Ensuring stable food availability and accessibility in times of high and volatile prices;
- Delivering public goods while addressing trade distortions;
- Promoting value addition and export opportunities.

### Establishing Equitable and Predictable Multilateral Rules

WTO negotiations on agriculture have languished for nearly 15 years. At the heart of the matter is a disagreement among large industrialized countries and emerging economies over their respective level of concessions. Important steps were taken in Nairobi in December of 2015 with respect to some of the persistently evasive elements, namely establishing a special safeguard mechanism for developing countries and dealing with export subsidies and other “export competition” practices. Specifically, the Nairobi decision states that developing countries will “have the right to have recourse” to a special safeguard mechanism based on import quantity and price triggers. With respect to export competition, the Nairobi decision groups together export subsidies with other types of instruments which can provide similar types of support and makes decisions for the staggered phase out of all forms, with significant differentiation in terms and conditions for countries at different levels of development and countries with particular sensitivities. These elements include export credits, export credit guarantees and other types of export financing; exporting state trading enterprises; and food aid. On export subsidies, the most egregious type of agricultural trade distortion, developed countries will immediately eliminate their remaining agricultural export subsidies, and developing countries must also eliminate their export subsidies by the end of 2018. Notwithstanding these advances, progress is needed on the other two pillars of the talks, market access and domestic support, to ensure that agricultural trade effectively performs its function of building bridges between deficit and surplus countries and so that international markets ensure the optimal use of scarce resources for the provision of food supplies. A first priority in this respect therefore consists in reviving multilateral talks. Two possible options are suggested, assuming a business-as-usual stance is unlikely to generate major progress:

- **The need for confidence building measures.** A first step consists in rebuilding trust among WTO Members by taking a series of small steps, following the ideas presented by the former chairperson of the agricultural negotiations under the Doha Round, Ambassador Crawford Falconer from New Zealand, at a November 2015 dialogue organized by the International Centre for Trade and Sustainable Development (ICTSD).<sup>109</sup> This could be done through a series of confidence-building commitments applicable initially over a one- or two-

year period. Such **non-binding commitments could be undertaken by individual WTO Members along the lines of what is currently envisaged in the draft negotiating texts** of the Doha Round. Such commitments could go only partially towards the reduction goals envisaged in those texts while WTO Members continue negotiating. **They could start with domestic support – an area where the gap between applied and bound levels is enormous – and progressively move to market access.** While not a binding commitment, it would be a serious undertaking by the participants, not to exceed a certain level during the life of the undertaking. An approach like this would be politically more palatable and would enable Members to show goodwill by initiating small concrete steps towards future reform. It would also help reinject confidence in the negotiations as a necessary condition for reviving a multilateral approach.

- **A plurilateral agreement on agriculture.** Another approach consists in initiating a plurilateral negotiation on agriculture market access and domestic support. Two variables have been suggested. The first is a club approach as proposed by Aluisio de Lima-Campos.<sup>110</sup> Such a plurilateral agreement would bring together like-minded partners to remove trade barriers in agriculture or at least in a set of core commodities and reduce domestic support, with rights and obligations accruing only to the signatories. Discussions should start with a core group, which could be formed from the main exporting countries with other Members being invited to join the discussions if they like what they see. The agreement itself would follow the model of the Government Procurement Agreement and would therefore **require a waiver to the Most Favoured Nation clause as envisaged under Article IX.3 of the General Agreement on Tariffs and Trade (GATT) 1994.** If consensus for such a waiver cannot be reached, it would have to be achieved through a three-quarter majority vote as envisaged under GATT Article IX.3. The second approach is “**Open plurilateralism**”, a variant proposed by other observers, most notably Peter Gallagher and Andrew Stoler<sup>111</sup> who, based on calculations made by academics from Australia, Brazil, China, India and Indonesia, estimated that gains from **a critical-mass plurilateral on most-favoured-nation basis** could be equivalent to gains eventually obtained from the Doha Round negotiations following the principle of *single undertaking*. Such a framework, in which the benefits of the agreement will equally accrue to signatories and non-signatories, has been followed within the WTO for other sectors, most notably the International Technologies Agreement and the ongoing negotiations towards an Environmental Goods Agreement, both limited to market access. An example of a plurilateral covering rules, which would be needed to tackle the critical issues of agricultural domestic support (subsidies), is found in the Basic Telecommunications Agreement. A successful effort would **require the identification of a set of key commodities and of respective countries participating in its trade so as to constitute critical mass**, a self-defining concept dependent on the minimization of freeriding by non-signatories. Theoretically, in time, other countries would join and the arrangements would eventually result in a universal agreement.

## Ensuring Stable Food Availability and Accessibility in Times of High and Volatile Prices

While agricultural markets have arguably always been exposed to some price volatility, the magnitude and frequency of recent price spikes have hit low-income food-deficit countries particularly hard, with significant effects on nutrition, thereby pushing food security back to the top of the political agenda. Several options are suggested to protect both poor consumers and producers from short-term price fluctuations.

### Disciplining Export Restrictions

As seen during the 2008-2011 food crisis, export restrictions can significantly contribute to exacerbating the negative effects of price spikes on food security, by reducing the ability of poor consumers in food-importing countries to access adequate food at affordable prices. These restrictions also undermine confidence in international markets as a reliable source of food and lower incentives to invest in agriculture, where a competitive advantage in production exists. Finally, in the absence of international cooperation, their competing effects partially offset each other, significantly lowering the effectiveness of these policy instruments in keeping domestic prices low. **Agricultural export restrictions are a policy area that is “under-regulated” in the WTO.** At the same time, it is an area where achieving political consensus remains particularly challenging. Bearing in mind this reality, changes could be introduced in the rules, even in a relatively low-ambition WTO agreement. Under this scenario, three incremental options could be envisaged.

- Exempting humanitarian aid. A first step could consist in ensuring that food is exempted from export restrictions or taxes in those cases where it is purchased by international organizations to be distributed on a non-commercial basis for humanitarian purposes. The impact on volumes traded and market prices would be marginal, while benefits in terms of the amount of food such organizations would be able to distribute under their relatively rigid financial constraints would be sizeable.
- Clarifying the disciplines. A second, relatively more ambitious option would leave current disciplines unmodified, but would **make them enforceable** by clarifying some of the key terms used, such as “temporarily”, “prevent”, “relieve”, “critical shortage” or “essential”, supported by stricter transparency and notification obligations.
- Disciplining export restrictions in a flexible way. In the longer term, more ambitious reforms could **simply prohibit export restrictions and taxes** and then define a set of exceptions limited to developing countries, circumscribed in terms of duration and product coverage and based on transparent triggers. This

could include a “taxification” (tariffication) of existing restrictions other than taxes, i.e. their replacement with “equivalent” export taxes, combined with reduction commitments. A special safeguard clause would make it possible to introduce an export tax above the maximum level otherwise allowed, for a limited time and under special circumstances. To guarantee minimum export volumes, export quotas at reduced tax rates could be introduced. Finally, special and differential treatment would apply to developing countries (exemption from tax reduction commitments and the introduction of bound tax rates instead, and smaller tax rate quotas).

### Updating Public Stockholding for Food Security Purposes

Price support schemes implemented as part of public stockholding programmes for food security purposes have focused a lot of attention in WTO circles as some countries were reportedly about to breach their domestic support ceiling under WTO rules. In practice, most of these schemes tend to provide a minimum guaranteed price to farmers supported by government purchases. At the heart of the matter is the fact that the subsidy provided by the price support is calculated on the basis of a fixed external reference price. This fixed reference price was established at the end of the Uruguay Round and does not capture the large increase in food prices over the last few decades. It therefore grossly overstates the economic subsidy provided. From an economic perspective, a simple solution to this largely political debate would consist in **updating the 1986-1988 fixed reference price** used as the benchmark for calculating the level of price support, by using either a more recent period or alternatively a rolling average of world prices based on the most recent three to five years. A similar way of addressing this concern was suggested by Diaz-Bonilla.<sup>112</sup> It starts from the realization that in many cases administered prices have consistently been below the world market price. This means that in pure economic terms, there has been no trade distortion created by the administered price. Diaz-Bonilla therefore suggests that **if the administered price is at or below the market price, it should not be considered as providing price support and therefore could be considered green box compatible.**

### Creating More Market Transparency

Global food security is under serious strain when prices increase suddenly and importing countries face unexpected difficulties in obtaining access to supplies. Market transparency, by allowing governments and private agents to prepare for changing market conditions, can greatly help to avoid such situations. Following the 2008-2011 episode with food price spikes, an international Agricultural Market Information System (AMIS) for major food crops was initiated by the G20 Agricultural Ministerial in 2011. The effective functioning of AMIS depends

critically on the willingness and capacity of all nations to supply the system with comprehensive, timely and accurate data. Of particular importance are data on stockholding, both public and private, which are notoriously deficient in many countries or are not made available publicly. **Governments must ensure that they provide this crucial data, including information on stock levels on farms and in commercial enterprises.** A firm commitment by as many countries as possible to cooperate closely with AMIS and provide full access to data could make an important contribution to strengthening global food security through improved transparency.

### **Supporting Emergency Reserves**

Attempts at taming the volatility of global food markets through internationally agreed buffer stocks have largely failed in the past. Large-scale national stock policies are equally ineffective and their cost-benefit ratio is highly doubtful. Targeted humanitarian emergency stocks of food, however, are a different matter. Their purpose is to guard against a breakdown of physical supplies (e.g. because of warfare, natural catastrophes, the interruption of transport channels, or export bans) and the resulting threat to food security. In situations of this sort, the only effective remedy to guard against a breakdown of physical supplies is stockholding, preferably not too distant from where the food is needed. The size of these emergency stocks can be limited as alternative sources of supply can typically be mustered after a while. It is the poor who suffer in such a situation: they should therefore be the target population for emergency reserves. Depending on conditions in the territory concerned, emergency stocks may be most effective either at the national or regional level. Designing, setting up and maintaining emergency reserves is costly. Also, systems must be created and implemented to distribute food from the reserve promptly, efficiently and in a fair manner. None of this is cheap. **The international community can help improve food security in times of crisis by supporting the establishment of emergency humanitarian food reserves.**

### **Creating a System of Global Food Stamps**

Risk management schemes for consumers can also play a critical role in ensuring food security. As experienced during the food price spikes, the access to food of poor families, who can spend 70% or more of their income on food, is threatened when food prices suddenly spike. Managing that risk should be considered one of the most important elements of any strategy to improve global food security. Social safety nets are an effective approach to managing risks for vulnerable people, including the risk of rocketing food prices. They serve to make purchasing power available to those in need without distorting trade. Several variants in design have been applied or tested, and overall experiences are positive. A **system of global food stamps** or similar approaches, **such as the “transfers to cover the poverty gap”** proposed by the FAO, the International Fund for Agricultural Development

(IFAD) and the World Food Programme (WFP), **are policies worthy of particular attention in this respect.** Establishing and financing social safety nets, including the institutional and physical infrastructure required for their successful operation, is a demanding task for developing country governments. Moreover, funding the operation of a safety net over a potentially extended period during which protection against exploding food prices is needed may well be beyond a government's capacity. International assistance in both the design and funding of social safety nets can therefore make a helpful contribution to improving food security.

### Delivering Public Goods While Addressing Trade Distortions

Beyond export subsidies and trade distorting domestic support currently addressed under ongoing negotiations, large subsidizing countries have increasingly had recourse to less trade distorting measures (i.e. green box subsidies) in an attempt to provide income support or the delivery of essential public goods. As these become the most prevalent form of support, ensuring that such measures achieve their stated objective while limiting potential distorting effects on trade and production has gained importance. Furthermore, in recent years, several new issues, such as biofuels mandates or trade measures designed to address climate change, have also emerged. Most of these were not in the minds of policy-makers when they launched the Doha negotiations in 2001 but have significant potential for creating negative externalities.

### Providing Public Money for Public Goods: The Need for Green Box Subsidies Reform

Since the end of the Uruguay Round, traditional providers of farm support have indeed reduced their trade-distorting aid. However, this move has often been accompanied by a proportionate increase in green box subsidies (i.e. subsidies with no or minimal trade distorting effects, in the WTO jargon). At the same time, green box support has been steadily growing in a number of emerging economies, such as China or India. As a result, green box payments today represent by far the largest share of global agricultural support. As an ever-greater proportion of subsidies are notified as "green box", ensuring that such measures do not cause more than minimal trade distortion becomes critical. In practice, this is essentially an empirical issue that can hardly be assessed *ex ante*.<sup>113</sup> The draft Modalities of 2008 contain a number of suggested refinements to policy-specific criteria, typically derived from experiences in implementing the green box subsidies since the Uruguay Round. One of the suggested changes that would appear to be important is that the basis of certain payments should be a "fixed and unchanging historical base period". Other options could include the following:

- Enhancing transparency. A first step could consist in improving transparency, and helping to monitor policy development, by requiring that notifications provide more detail on the implementation of measures to be covered by the green box

so that their potential trade impact can be more effectively assessed and their green box status can be challenged if necessary.

- Capping income support measures. A more ambitious approach could consist in making a **distinction between “payments for public goods” and “income support”**. Measures that aim at correcting persistent market failures or ensuring the delivery of public goods, such as biodiversity conservation, climate change mitigation, infrastructure development, or research and development might require long-term government intervention. Even if some limited production and trade impacts were to result from these policies, there would be no clear logic for constraining them as long as those market failures persist. On the other hand, measures primarily aimed at providing income support to farmers might need some form of limitation or cap. Although these may play a critical role in facilitating reforms by compensating negative income effects resulting from cuts in the more trade-distorting measures, they arguably ought not to be provided on a permanent basis and should therefore be time-limited. Limiting such payments would alleviate concerns around their potential trade distorting effect and would provide greater parity between governments with high fiscal revenues and those without.

## Assessing Support to Biofuels

As in the case of barriers to food exports, government support for the production and use of biofuels was not considered an important issue for international trade relations as long as international market prices for agricultural products were depressed. However, when global food prices began to rise, thereby placing a growing burden on consumers, support to biofuels appeared in a new light.

- Notifying biofuel support. A first and rather fundamental option would be to create more transparency regarding the types and levels of government support to biofuels. **So far, notifications are far from comprehensive and where they occur they do not provide sufficient detail to allow an analysis of their trade implications.** Transparency would be greatly improved if clear rules were developed as to how and where support to biofuels has to be notified and which forms of support are to be covered.
- Disciplining biofuel subsidies. Considerably more demanding would be an option that aims at establishing effective and comprehensive disciplines on the magnitude and use of the support to biofuels. This would require some innovation in legal approaches, for example regarding the use mandates as a form of subsidy. Given the close relationship between biofuels and the food and agriculture sector, it might make sense to consider the option of adapting existing rules such that biofuel support falls under the realm of the WTO Agreement on Agriculture (AoA). Introducing disciplines for support to biofuels under the AoA would be in line with the suggestion to establish constraints on product-specific support as foreseen in the 2008 draft Modalities.

## Addressing Climate Change

It is now widely recognized that the biophysical impacts of climate change, including long-term changes in temperatures and precipitation and the increased likelihood of extreme weather events, will alter crop and animal productivity and ultimately modify trade flows. These changes will affect individual countries differently depending on the effect of climate change on their agricultural productivity and their trade exposure. At the same time, agriculture is a significant source of global greenhouse gas emissions, although it can also contribute to carbon sequestration. From a food security and trade perspective, a key issue is whether policy measures that are emerging to promote mitigation or adaptation in the sector are consistent with frameworks aimed at ensuring the availability of food, including in the GATT/WTO.

In this respect, the pursuit of climate change policies for agriculture opens up the requirement for an international consensus on the domestic policy measures that are likely to be effective in tackling the effects of climate change in agriculture and that are also the least distorting of markets. Enhanced monitoring and scrutiny of the measures used are also needed. In this context, some important priorities relating to climate change measures could be addressed. These include:

- Avoiding trade distorting measures. The clarification of criteria to be applied under the green box in Annex 2 of the AoA, to ensure that these exempt policies have clear climate change objectives, combined with enhanced transparency and scrutiny of such policies to ensure that they are minimally production and trade distorting;
- Supporting agricultural productivity in least developed countries. The provision of special exemptions for the least developed countries for measures used to increase agricultural productivity and resilience in the face of climate change, to enable adaptation to climate;
- Defining a framework for carbon adjustment measures. A clarification of the conditions under which the WTO permits the use of border measures designed to prevent trade from undermining the effectiveness (and political acceptability) of domestic policies in this domain – i.e. to avoid “carbon leakage” and equivalent impacts.

## Promoting Value Addition and Export Opportunities

The economic context in which agriculture operates is changing rapidly. The same processes driving the emergence of global value chains in other sectors are also at work in the agri-food sector, notably technological change, and transport and logistics innovation. Changes in food retailing are leading to the private sector’s greater involvement in agriculture. Initially motivated by export market opportunities, value chains are also extending their reach into domestic markets as retail markets evolve to meet the needs of urban consumers. Integration and

upgrading in such value chains has become a priority for governments seeking to promote diversification, value addition, technology diffusion and better employment opportunities in the agricultural sector. Several challenges, however, are affecting the development of such value chains, including the cost of production, but also transport and storage, cold chain management, or certification. The ability to meet standards and product specifications also plays an increasingly prominent role in the sourcing and investment decisions of lead firms. Finally, access to finance and the lack of infrastructure are also major sources of concern for suppliers in developing countries. Several policy options have been identified through the E15 Initiative to make progress in ensuring that food gets from the farms to the tables of consumers.

### **Facilitating Trade in Agriculture**

In a global agricultural system increasingly dominated by global value chains, viability and efficiency are significantly increased from simplified customs procedures and lower transaction costs. In developing economies, significant benefits can also be derived from a possible boost in intraregional trade where a considerable growth potential remains untapped. While some products might be directly exported internationally, in a number of cases products are sent from one country to another for further processing and packaging before eventual export to further destinations. In other cases, goods are moved in transit to different ports, and some are directly shipped from various ports in the subregion. In most cases, agricultural products cross borders and are therefore subject to border formalities. At the regional level, integrated trade facilitation procedures would contribute to improving systems of permit issuances, product certifications and inspection procedures through cooperation, compatible systems and information exchange. To address this concern, a first step will consist in developing **regional trade facilitation plans for food and agriculture**. Such approaches would go beyond the fairly narrow approach envisaged under the WTO Trade Facilitation Agreement. It could rather focus on the development of regional infrastructures and trade financing facilities, but also on the development of databases and data exchanges of agricultural products, the formulation of import and export permits, the issuance of permits and mutual recognition, sanitary inspection facilitation, linkages with certification bodies, capacity building and training for national agencies. This could contribute significantly to the movement of food staples, inputs and processed foods, effectively enabling the functioning of regional value chains in the agri-food sector and considerably improving the supply of food while at the same time generating opportunities for poverty reduction, employment creation and export earnings.

### **Harmonizing Standards and Supporting Regulatory Coherence**

As tariffs applied in agricultural trade have declined in recent decades, non-tariff measures (NTM) have gained in importance. In trade in agricultural and food products, sanitary and phytosanitary (SPS) measures are the most prominent

NTM and often affect developing countries' ability to integrate supply chains and promote value addition. Their use is regulated through the SPS Agreement. One of the key aims of the SPS Agreement is the greater harmonization of health and safety standards.

- Improving the use of international standards. A major improvement in this regard would be more ample **use of international standards in national SPS regimes**, as advocated by the SPS Agreement. So far, the use of international standards is fairly limited, with substantial variations across countries, products and regulatory objectives. Developed economies have tended to use international standards less than developing countries. More comprehensive and accurate information on the extent to which individual countries have adopted international standards (and publication of that information) might pave the way towards greater use of international standards. Countries, in their notifications of SPS measures to the WTO, should explain conclusively why they do not apply international standards when that is the case.
- Multilateralizing transparency provisions existing in RTAs. RTAs can be credited for introducing WTO-plus obligations that strengthen the *ex-ante* and *ex post* transparency requirements related to the design and application of standards and for establishing improved web-based information systems and consultation processes that include interested foreign parties. Since transparency displays the characteristics of public goods, the multilateral extension of these commitments would come at no additional economic cost for countries that have already implemented them unilaterally or regionally.
- Providing support for effective SPS regimes. Because of capacity constraints, developing countries face particular difficulties in establishing effective SPS regimes. Assistance to build the capacity to implement international SPS standards, guidelines and recommendations is urgently needed, not only for trade-related issues but also to improve the quality of domestically produced food in developing countries and to protect their productive capacity from pests and diseases.

### Examining Private Standards and Certification Schemes

The road to diversification, value addition and industrialization in a modern economy involves linking up effectively with global supply chains. In some of these, important purchasing firms act together and establish industry-wide standards (e.g. EurepGAP or GlobalGAP, where the "GAP" stands for Good Agricultural Practices, required by big supermarket chains). This type of industry-wide private standard affects a large number of suppliers. They may be conflicting or even contradictory and difficult to comply with for many firms, especially small and medium-sized enterprises (SMEs) in developing countries. Moreover, the justification for their existence may not always be sound. For many developing country exporters, private standards are more significant constraints than official SPS standards and

technical barriers to trade (TBT). Fair trade and organic standards, for example, which sometimes provide export opportunities and value added, would be more effective if they were harmonized. While these difficulties with privately determined standards are akin to those associated with the SPS and TBT Agreements of the WTO, important differences exist. The latter are subject to WTO disciplines and can be challenged, albeit not always effectively. Private standards, on the other hand, are self-regulated by the big firms. Assistance to understand and comply with private standards is left to the goodwill of the dominant firms in the supply chain. For private industry-wide standards not to be a constraint but rather a conduit for effective participation in global supply chains, particularly for SMEs, existing limitations can be tackled through:

- Scrutiny and oversight, as well as information dissemination and guidelines concerning private standards, particularly industry-wide ones, that affect large numbers of suppliers; these activities could be undertaken by public bodies (national and international), private sector representatives from developed and developing countries, and civil society; they could involve examining whether they are compatible with the requirements of the SPS and TBT Agreements of the WTO and other international agreements;
- The application of public pressure and the provision of guidelines on harmonizing multiple, rival or conflicting standards employed by large firms or industry-wide standards, including fair trade and organic standards;
- The development of model contracts for selected sectors (e.g. agriculture, fishery, forestry) and the identification of possible “honest brokers” to assist in the formulation of contracts in which developing country firms enter with large established firms;
- The inclusion of compliance with private standards in Aid for Trade programmes.

### **Promoting an Integrated Agri-Food Value Chain Approach to Future Negotiations<sup>114</sup>**

Current trade negotiations under the WTO or in the context of regional trade agreements continue to take a fairly traditional approach to “agriculture” by focusing on agricultural goods and nothing else. But the reality of farming is quite different. Farmers need inputs from seeds to fertilizer to capital equipment and extension services. They also need storage and transportation. They may even want to extend their own operations further up the value chain into processing by joining a cooperative. To accomplish that, farmers do not simply need a reduction in tariff barriers affecting their exports in particular markets or cuts in domestic support. They also need to reduce the cost of their inputs and their storage, handling and transport. They would also benefit from access to communications technology that would offer them greater efficiencies through access to state-of-the-art knowledge on, for example, agronomy and soil science, and up-to-date market information that would help them with planting and harvesting decisions. In

short, what they need is to address all tariff and non-tariff measures that impede their ability to raise their productivity and connect to markets in a coherent way. **An agri-food value chain approach to trade negotiations would provide an opportunity to address all these aspects in an integrated manner, ranging from tariffs and non-tariff barriers, services related to agriculture (e.g. storage, handling, shipping or processing), seeds, pesticides and fertilizers, trade facilitation, transport and logistics, innovation, ITC, etc.** Negotiating in “clusters” has not yet been attempted on a significant scale in the WTO or in other negotiating fora, but this arguably represents a promising route for adapting global trade and investment governance to a world characterized by global value chains. Doing so would also create a broader range of opportunities for trade-offs that would facilitate the conclusion of an agreement.

## Conclusion

The E15 Expert Groups have developed an ambitious yet practical agenda of changes in the international trade regime that would deliver major benefits in ensuring that international governance frameworks are supportive of food security concerns. If implemented, such an agenda would help revive ongoing multilateral negotiations on agriculture and design relevant disciplines in areas such as export restrictions, biofuels or climate change, while ensuring a fair, predictable and more stable trading system. Priorities for policy orientation are shaped by the most pressing challenges of the time. The changing conditions on agricultural markets since the turn of the century have brought to the fore the need to focus more on food security. Hunger and malnutrition are by no means a new phenomenon and have long been a top priority for the international community. Yet the specific food security problems resulting from conditions in international markets for food and agricultural products have come sharply into focus as a result of the dramatic price peaks experienced in recent years. For this reason, the measures proposed here, many of which can be implemented in the short run, deserve to be a central element of international economic cooperation over the years ahead.



## Preserving National Policy Space to Make Societal Choices

International trade agreements and arrangements inherently entail a reduction in national policy autonomy. States created the General Agreement on Tariffs and Trade in 1947 with the collective damage caused by the self-defeating, beggar-thy-neighbour unilateral protectionist measures of the 1920s uppermost in mind. Similarly, the international trading system is replete with bilateral and plurilateral trade and investment agreements in which signatories reduce or impose a cost on their freedom to impose tariff and non-tariff barriers in a legally binding fashion. International trade negotiations are fundamentally exercises in which governments offer to selectively cede national policy space in return for the prospect of broader, mutual welfare gains.

Nevertheless, there is rising concern among some countries and constituencies that international trade and investment liberalization have gone too far in the sense of unduly restricting the ability of governments to pursue critical national objectives that their societies may value as much as or more highly than the facilitation of cross-border trade and investment. This concern tends to be expressed in two primary ways:

- 1) Industrial development. Developing countries today have less latitude than their advanced country counterparts did decades ago to pursue active industrial development policies by virtue of their membership in the World Trade Organization (WTO) and regional free trade agreements (FTAs);
- 2) Societal values. International investment treaties and agreements and certain behind-the-border provisions of FTAs are unduly constraining the latitude governments have to set regulations that give effect to their societies' values and choices in such areas as public health, environmental protection, labour and human rights, consumer protection and cultural heritage.

### **Industrial Development**

The Expert Group on Reinvigorating Manufacturing examined the industrial policy experience of a wide range of countries, particularly the successes enjoyed by a number of middle-income countries in recent decades.<sup>115</sup> Based on this review, it considered whether the modern trading system has in fact “kicked away the ladder” climbed by advanced countries in their earlier pursuit of industrialization and if a corresponding modification of trade and investment rules to restore policy space is therefore justified.

The Group generally concluded that for the most part current international trade disciplines did not and still do not pose a significant barrier to the kinds of strategies that have proved effective in places such as South Korea, Taiwan, China and India. This is principally because:

- While multilateral disciplines do exist and have been tightened in some respects in recent years regarding “vertical” or industry-specific policies (notably, intellectual property rights), most such strategies are still available to developing countries on either a *de jure* or *de facto* basis;<sup>116</sup>
- The most effective policies for spurring industrial development have in fact proved to be “horizontal” (not industry specific) in nature, and these measures are essentially unconstrained by international trade and investment disciplines.

### **Vertical Policies**

- Tariffs. Most developing countries have WTO tariff bindings well above their applied rates, affording them some room for infant industry protection (for example through tariff escalation on finished product imports) if they believe such a strategy would be beneficial.
- Subsidies. General subsidies are freely allowed by the WTO Agreement on Subsidies and Countervailing Measures, and even most narrower domestic subsidies (e.g. for industrial production or research) are not prohibited, although they could be challenged if adverse effects can be demonstrated in what is often a lengthy and demanding WTO adjudicatory process. As a result, such challenges seldom occur except in the case of the largest players. Even export subsidies, which are generally prohibited, are allowed for non-agricultural products of poorer developing countries (i.e. those that have yet to surpass \$1,000 per capita income in 1990 dollars for three consecutive years).
- Government procurement. Governments are freely permitted to procure locally, provided there is no link to a domestic subsidy, and to impose offset requirements in defence procurements from foreign suppliers.
- Local content requirements. Local content requirements are generally prohibited for non-governmental procurement by the WTO Trade-Related Investment Measures (TRIMs) agreement; however, they have proliferated across countries and industries and gone largely unchallenged.<sup>117</sup>
- Intellectual property. The one area in which current international disciplines have noticeably constrained practices that were used to considerable effect from the 1960s to 1990s is that of intellectual property rights. Many of today’s newly industrialized countries made extensive use of reverse engineering in their early industrialization, the scope for which has been greatly narrowed by the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement.

However, many countries have adapted by encouraging joint ventures with or purchases of foreign firms possessing technology considered important for the development of a targeted domestic industrial capability, often in concert with state-sponsored public-private research, development and diffusion (RD&D) activities, which also remain effectively unconstrained by international law.

- State-owned enterprises. SOEs remain largely unconstrained by multilateral and even most regional FTA rules even though they often enjoy considerable tax, financial and regulatory advantages vis-à-vis their privately held counterparts. SOEs represent an estimated 60% of world merchandise and 21% of services trade.<sup>118</sup>

## Horizontal Policies

The evidence on industrial development during the past 50 years suggests that horizontal policies to improve the enabling environment are ultimately more important to success than vertical ones, and these are not limited by the multilateral trade and investment regime. Specifically:

- Improvements in **infrastructure, education and training, enterprise development, entrepreneurship, innovation, finance and social policies** create the potential for positive spillover effects from early manufacturing successes to take root and spread locally.<sup>119</sup>
- In particular, by combining **parallel improvements in the enabling environment for the private sector and skills development with openness to hosting foreign direct investment** in key sectors, countries create the possibility for technology and know-how from those foreign firms to be transferred more widely and organically through the bottom-up creation of forward and backward linkages. These linkages can build over time into clusters of industrial capabilities that propagate local production, investment and innovation.<sup>120</sup>
- These clusters can be reinforced and accelerated through efforts to attract investments by lead firms in global or regional value chains by maintaining a hospitable tariff and non-tariff barrier environment for the importation of key inputs, including improvements in trade facilitation (particularly customs and logistics). In this sense, **modern industrial policy emphasizes the promotion rather than restriction of trade and investment**.
- This brand of industrial policy, which has been employed with considerable success in many of today's upper-middle-income countries, **requires a systems approach** – i.e. a recognition that successful industrial development is a process involving the ongoing upgrading particularly of skills, infrastructure and economic institutions, not least the professionalism and insulation from rent-seeking behaviour of vested interests of economic policy-making and regulatory institutions.

- This approach can be usefully combined with vertical policies such as some of those highlighted above. But these more targeted initiatives are more likely to be effective and cost-efficient when they are executed within a robust horizontal enabling environment and determined through a **rigorous and dynamic evaluation of the country's latent competitive advantages** in the ever shifting international economic context.<sup>121</sup>

## **Societal Values**

The other major question increasingly raised about policy space is whether the international trade and investment regime is unduly usurping the traditional role of national governments to give effect to social values and choices determined through democratic decision-making processes in such areas as public health and safety, environmental protection, worker and human rights, cultural heritage and rural livelihoods.

This concern has surfaced most prominently in criticism of the investor-state dispute settlement procedures of many bilateral investment agreements and some FTAs, including in the recent case of the Transatlantic Trade and Investment Partnership (TTIP) negotiations between the United States and European Union. But the investor-state dispute resolution debate is a manifestation of a wider question about the appropriate limits of international economic integration, in particular of a new generation of FTAs that are aiming at much deeper integration of economies through an expansion of cross-border investment and trade in services (e.g. the Trans-Pacific Partnership (TPP), Pacific Alliance, TTIP and recent bilateral FTAs, particularly among Organisation for Economic Co-operation and Development (OECD) countries).

By virtue of their emphasis on investment and services, these new trade initiatives are increasingly focused on improving regulatory coordination, sometimes on topics for which societies have differing or still-evolving underlying value systems (e.g. precaution, privacy, industrial relations, etc.). The question therefore is: what is the right balance between investor and citizen rights, between investment certainty and democratic due process, as well as between regulatory coherence in a highly integrated world economy and deference to legitimate national values and choices?

Notwithstanding the public debate and controversy on this topic, there have been relatively few specific cases in which there was a demonstrable failure to reconcile these interests satisfactorily. Nevertheless, the perception that this is a legitimate problem has taken hold and is growing due to the proliferation of negotiations on deep-integration agreements. The issue therefore merits consideration in a strategic review of opportunities to strengthen the long-term prospects of the global trading system as an engine of economic and social progress.

E15 Expert Groups identified several opportunities to address these concerns and help strike a better balance:

### Modernize and strengthen the coherence of investment agreements

The Expert Group on Investment Policy has developed a multi-tiered set of recommendations for improving the international investment regime and striking a better balance among investor, host government and citizen interests therein. The regime now consists of about 3,300 bilateral and plurilateral agreements – up tenfold in the last 25 years. The Group suggests building on the recent changes that have been incorporated in model investment agreements of countries as diverse as Norway and India, as well as the work under way and mandated by the United Nations Financing for Development conference in Addis Ababa at the United Nations Conference on Trade and Development (UNCTAD), in the following manner:

- A consultative process to develop an **updated articulation of the overall purpose** of international investment agreements (IIAs) could be created that would encompass not only investor protection against arbitrary measures but also the facilitation of sustained investment in sustainable development and the preservation of a certain degree of domestic policy space to protect public safety and health.
- The Investment Policy Framework for Sustainable Development recently issued by UNCTAD could serve as a starting point for this process, which would seek to build common ground on not only the articulation of and set of definitions for this restatement of the purpose of IIAs but also the **design of the main elements of a 21st century international model agreement**, using as building blocks a few of the more recently concluded bilateral agreements and perhaps the prospective US-China bilateral investment treaty that is under negotiation.
- This new model framework, formulated as a best practice open for voluntary adoption, would be a bottom-up way to spur the modernization and harmonization of an international investment regime that has become highly complex and in some cases out of date. It could include a number of specific additional innovations that would help negotiating parties to **strike a better balance regarding the preservation of essential national policy space**, including:
  - An articulation of **fundamental investor obligations**, including with respect to responsible business conduct in areas like corruption, human rights and taxation (i.e. for example, the new OECD Base Erosion and Profit Shifting framework). Supplemental sector-specific responsible investment frameworks could be developed through public-private dialogue, such as in the area of responsible mineral and natural resource development.<sup>121a</sup>

- A new **international appeals framework** that states could choose to opt into as part of their bilateral or FTA agreements. This mechanism would provide recourse for either party of an arbitral judgment to an ad hoc appellate body composed of members from a pool of investment adjudication specialists accredited by the international framework.
- A new **dimension of citizen participation** modelled on the OECD Guidelines for Multilateral Enterprises. Specifically, a Consultative Committee for the new model framework could be established for the purpose of providing input into not only the elaboration of the framework but also its implementation. Various stakeholders could be accorded consultative status to identify and offer analysis of specific dispute settlement cases that they believe illustrate the need for further clarification or the evolution of the framework going forward.
- To help level the playing field for developing country governments that lack the legal expertise to defend themselves adequately, an **Advisory Centre on International Investment Law** could be established, modelled on the Advisory Centre on WTO Law. Created in 2001, this provides services to developing countries through its own staff or outside counsel at reduced rates.
- Donor countries could also provide assistance and support for **capacity building to developing countries** in the implementation of the new model framework by extending the WTO Aid for Trade initiative to cover investment-related as well as trade-related capacity building. These programmes of assistance could be shaped by the Investment Policy Reviews of UNCTAD or relevant reviews by OECD or the WTO.
- Finally, if constructed pragmatically through the incorporation of the best, overlapping practices of a number of existing agreements, the new model international investment framework could create the basis for a **plurilateral agreement** among interested states. In this way, it could help to rationalize the current, highly fragmented regime and spread a more modern and balanced approach to the preservation of policy space through the international community by a process of open accession. Indeed, it is not inconceivable that, over time, such a bottom-up dynamic could result in a critical mass agreement in which parties indicate that they would be prepared to offer the benefits of the framework, including those related to the rebalancing of policy space itemized above, to all countries on a Most Favoured Nation (MFN) basis.

## Create a safe harbour for subsidies to address market failures

The E15 Initiative Task Force on Subsidies made a set of additional proposals that would clarify (and thereby increase) the latitude governments have to address market failures or create public goods. They propose reinstating a modified version of Article 8 of the Agreement on Subsidies and Countervailing Measures concerning Non-Actionable Subsidies that expired in 2000. This would create a safe harbour for the use of subsidies that address four social objectives on the grounds that these are problems of the commons or other market failures whose remediation would have positive externalities. This expanded certainty under WTO law would have the effect of modestly enhancing the policy space of countries to pursue these societal priorities:

- Combat and adapt to climate change. The Task Force proposes to provide **safe harbour treatment for subsidies** encouraging the consumption of certain environmental goods deemed to be helpful in the reduction of or adaptation to global warming, irrespective of where they are produced. A starting point could be the list of goods targeted for the elimination of tariffs by the group of 17 countries negotiating an Environmental Goods Agreement in the WTO.
- Promote the economic and social inclusion of marginalized regions. Many countries, especially developing countries but also more advanced countries with disproportionately poor rural regions and urban slums, experience very high domestic disparities in the cost of investment in different regions and extreme variations in income and employment opportunities. A degree of subsidization may be justified to overcome these obstacles and widen social inclusion in the aggregate benefits that trade and other reforms may produce. Some form of safe harbour for regional development subsidies should thus be considered (as well as a *de minimis* level). To prevent abuse, such subsidies should be limited to doing no more than offsetting the additional cost of investment in that region. The safe harbour would also need to be limited to those regions of a country where the costs of investment and doing business were a defined percentage above the norm for the country at issue (other metrics could be considered, such as regional unemployment rates).
- Encourage research and development. Much research and development (R&D) entails short-term cost for benefits that are highly uncertain and often not specific to the sponsoring company. As a result, companies tend to invest less in R&D than is desirable for society as a whole. A safe harbour should thus be established for certain R&D subsidies. Any safe harbour, however, would need to be carefully crafted to avoid subsidizing R&D that would occur without the subsidies. Moreover, since the public would be funding such R&D (through the subsidies), the safe harbour could require that the results of the R&D be made publicly available to any agent who seeks to use it. While this requirement may act as a disincentive, there may still be an advantage to the firm conducting the research. Such a requirement would also serve as an incentive to companies to fund through commercial mechanisms some R&D they would otherwise fund with a subsidy, lest they be unable to retain the results of the R&D for their exclusive use.

- Recover from natural disasters and conflict. In recent years, the world has experienced natural disasters of such magnitude that recovery from them requires extraordinary investment. In these instances, there should be a safe harbour for subsidies provided to allow the industry or economy affected to return to its pre-disaster state. Any such safe harbour would need to be time restricted, with metrics established to determine when the recovery period has ended (perhaps using pre- and post-disaster employment and output levels as baselines). The safe-harbour would also need to be very specific on the magnitude of the natural disaster that would qualify for such treatment. The difficulty lies in narrowly crafting the safe harbour to permit subsidies to restore what was destroyed, without covering the cost of expanding or modernizing production. Metrics could possibly be developed by drawing on the experience and efforts of the UN Office for Disaster Risk Reduction with respect to risk reduction in determining when the disaster is of sufficient magnitude to qualify for a safe harbour on recovery assistance. This safe harbour could also be extended to recovery from acute man-made disasters such as war.

### Preventing a Race to the Bottom on Social and Environmental Standards

One of the popular concerns about the trading system often voiced in advanced countries is that trade liberalization has placed downward pressure on employment, wages, working conditions and public health and safety due to the large disparity between the level of labour, environmental and other social standards of advanced countries and those in most developing countries. In particular, the proliferation of FTAs between countries at vastly different levels of institutional development has fuelled fears of a race to the bottom in social conditions.

These constituencies are concerned that legal standards and protections that took decades to create through the political process and then implement through the administrative and judicial processes of their countries are being eroded for all intents and purposes as investors and managers respond naturally to lower costs of production and compliance in jurisdictions with weaker standards and enforcement. This implies not just a limitation of policy space, the reasoning goes, but an outright reversal of it.

Whatever the extent of empirical evidence of this phenomenon, concern about it is sufficiently widespread in some advanced countries that it has significantly undermined political support for trade agreements. However, attempts to address the problem in the WTO have met with stiff opposition from developing countries, who consider efforts to link improvements in their social standards and institutions to trade privileges as an intrusion into *their* domestic policy space.

Two proposals to break through this dilemma have emerged from the E15 deliberations, one structural and the other immediate and practical. Together, they have the potential to stimulate significant progress, **levelling up standards over time through regulatory cooperation among self-associating clubs of countries and the parallel scaling of responsible supply chain practices by multinational and other companies.**

## Expanding Plurilateral Regulatory Cooperation

There is ample precedent for groups of countries to negotiate regulatory coordination arrangements both within and outside the trade regime, and as for the latter, both within and outside the WTO. These can take the form of separate, specialized accords or chapters within more comprehensive agreements, like FTAs. Indeed, several bilateral FTAs among OECD countries and the recently concluded TPP have labour, environmental and other regulatory coordination provisions that extend well beyond existing WTO disciplines.

A pragmatic way for advanced countries to alleviate the real and perceived pressure placed by global economic integration on their policy space in respect of social standards would be to engage like-minded countries in open clubs that establish a common floor for such standards and encourage other countries to join by extending trade and investment preferences and substantial capacity-building assistance to them. This is at least in part the stated logic of the TPP – to set a somewhat higher set of standards in a variety of regulatory domains among a substantial group of like-minded countries that confer upon each other preferential market access.

The E15 Initiative Task Force on Regulatory Coherence viewed this dynamic – self-associating plurilateral coalitions or clubs of countries – as the most promising pathway for reconciling the interests of developed and developing countries on a range of regulatory coordination challenges, including those discussed in this chapter. There is nothing currently preventing the formation of plurilateral agreements of this nature. But in order for them to be part of the WTO and therefore accountable to it, they must be authorized (in advance) by unanimous consent of the WTO membership. This condition creates a significant disincentive to the creation of such agreements and attaches a certain stigma to them.

For this reason, the Task Force proposes to relax the unanimous consent requirement for the negotiation of WTO plurilateral agreements, permitting them to go forward and become part of the WTO oversight process and have access to its dispute settlement procedures unless 20% of the membership objects. It recommends that the WTO even *encourage* two particular types of plurilateral regulatory cooperation:

- Agreements that deal with issues outside of its existing mandate (which applies to most specialized areas of regulation, including those dealing with social and environmental matters), thereby creating a variable geometry that is more responsive to the heterogeneity of interests in its membership;
- Agreements that link similar provisions in different RTAs and preferential agreements together in a mega-plurilateral or even multilateral or “critical mass” MFN arrangement, strengthening the coherence of the regime and simplifying the efforts of companies to navigate it.

## Scaling Responsible Supply Chain Practices

Global and regional supply chains have expanded in recent decades to the point where they now account for roughly 80% of world trade.<sup>122</sup> The lead firms in these supply chains set many product standards and specifications for their contract suppliers. Many are increasingly setting process standards and specifications in line with a range of international norms, including official ones like the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, and others that are informal, such as the Marine Stewardship Council standards, Ethical Trading Initiative, Publish What You Pay campaign and Apparel Production Certification Program.

However, this activity is highly variable across firms, industries and host countries. In the aftermath of the 2013 Rana Plaza disaster, in which 1,134 people perished in a sweat shop factory collapse in Bangladesh,<sup>123</sup> the international community has begun to marshal a more concerted approach that has considerable potential to contribute to the improvement of working conditions in developing countries if pursued in earnest, notwithstanding the underdevelopment of labour and environmental regulatory frameworks and institutional capacity common therein.

In 1993, eminent Indian-American economist and free trade advocate Jagdish Bhagwati proposed a straightforward solution to this problem. He suggested that multinational enterprises be encouraged and even expected by their home governments and shareholders to apply to their operations abroad the basic worker rights and pollution control rules to which they are subject in their home country. Establishing this informal norm, he argued, would go a long way towards addressing the concern in advanced countries about the implicit subsidy or artificial advantage represented by weaker standards in poor countries, and it would do so without prescribing legal and institutional changes that would impinge on domestic policy autonomy.<sup>124</sup>

In June 2015, under the leadership of Germany, the G7 agreed to a multifaceted initiative to spread responsible labour and environmental practices throughout the worldwide supply chains of companies headquartered in their countries,<sup>125</sup> including:

- Creating a Vision Zero Fund to support measures for improving labour, social, environmental and safety standards in cooperation with the International Labour Organization;
- Committing to strengthening the use of the OECD Guidelines for Multinational Enterprises to promote supply chain sustainability and to support the development of National Action Plans to give effect to the UN Guiding Principles on Business and Human Rights;

- Committing to strengthening relevant multistakeholder initiatives in their countries and partner countries, including in the textile and ready-made garment sector, building upon good practices learned from the Rana Plaza aftermath;
- Improving the coordination of bilateral development cooperation to support developing countries in taking advantage of responsible global supply chains to foster their sustainable economic development.

The G7 Initiative should become a rallying point for public-private cooperation to scale the voluntary application of best practices in such standards throughout global supply chains through a combination of governmental jawboning and funding of developing country technical assistance and intergovernmental organization and non-governmental organization advice and support, as well as CEO and trade association engagement and outreach. A concentrated effort over the next two to three years could build a critical mass of corporate adherence within most key industrial sectors.

Corporate social responsibility initiatives, such as Social Accountability International,<sup>125a</sup> the Business Social Compliance Initiative (BSCI),<sup>126</sup> the Ethical Trading Initiative (ETI)<sup>127</sup> and the Fair Labor Association (FLA),<sup>128</sup> have been working for decades to support decent working conditions in global supply chains. The social auditing industry has also evolved. The Global Social Compliance Programme (GSCP),<sup>129</sup> for instance, was created by global brands and retailers in an attempt to improve sustainability along supply chains through harmonization and the sharing of best practices.

## Conclusion

Striking an appropriate balance between the preservation of national policy prerogatives and the promotion of international trade liberalization and regulatory coherence promises to be one of the most difficult challenges the global trade regime will face over the next 10 years. But while little progress has been made in this area over the past 10 to 15 years, the E15's work suggests that a productive way forward is possible. Several specific improvements could be made in hard and soft law that, in combination, would significantly improve the economics and politics of trade in developing and developed countries alike. But this will require moving beyond a narrow focus on the multilateral negotiating arena and making use of a wider set of cooperative tools.



## Strengthening the Legitimacy of the Global Trading System

Over the past 25 years, most governments have been shifting policies to encourage the integration of their national economies into global markets. They have done so in line with rules established by the multilateral system in the General Agreement on Tariffs and Trade and World Trade Organization as well as those of relevant regional free trade agreements or bilateral accords. Domestic institutions have been positioned to support this process and help businesses and consumers capitalize on the corresponding opportunities and benefits.

In many regions of the world, trade and investment have channelled industrial and technological developments supporting specialization and scale into rapid export-led or value-chain-driven growth. This has helped lift millions out of poverty, dramatically improving the quality of lives as well as facilitating access to education, medicine, skills and knowledge. Trade and investment are primary drivers behind today's hyperconnected world, built on technological improvements in transportation and communications. From smartphones to cars, food, energy or banking services, our everyday experiences are populated by the outcomes of international exchange. So goes one narrative of today's globalized world.

For others, the trade and investment story is rather different. For them, the integration of national economies into global markets is a phenomenon frequently accompanied by a range of ills from unemployment to migration, anticompetitive practices, pollution, environmental degradation and climate change, exploitation and threats to the national regulatory process. The gains from trade and foreign direct investment (FDI) have been too narrowly diffused, and global financial instability has generated unwelcome volatility. This sceptical counter-narrative about the net benefits of liberalization is on the rise in countries rich and poor.

John Rawls's seminal writings on fairness frame the legitimacy of a system in terms of its ability to deliver for the least advantaged.<sup>130</sup> The current public debate favours the view that globalization, and the multilateral trade system, have exacerbated inequality and challenged governments' abilities to address social inclusion. The poor and least advantaged have often been marginalized from the global economy. Even though in the immense majority of cases the cause is found in deficiencies in domestic institutions and shortcomings in flanking policies, the institutions of the global trade system are commonly used as a scapegoat. In those instances where the norms and the institutions that govern trade are insufficient or perverse in delivering for the least advantaged, corrections must be cooperatively made.

Inclusion implies the ability of small players, such as small and medium sized enterprises (SMEs), to benefit equally from global markets alongside big companies and investors, as well as the ability of smaller and disadvantaged economies to harness the opportunities the system offers. Amartya Sen reminds us that the evaluation of justice need not be binary but instead a matter of degree.<sup>131</sup> While the

global trading system needs to ensure fair outcomes for all to maintain legitimacy, interpretations of fairness may vary. In today's fragmented trade landscape, questions abound on the ability of the system to integrate all interested players into global markets and to deliver on some key services – including rule-making, strategic oversight, monitoring and compliance, standard setting, stakeholder engagement, among others.

These challenges are complicated by the rapid transformation of what is being traded and how over the last few decades. Annual services trade growth now far outpaces that of manufactured goods. The Internet has empowered the explosion of a digital economy, giving rise to new content, entrepreneurs and markets. There is an increasing fragmentation of production of goods and services in global supply chains. As coordination and trade costs have plummeted, firms have built sophisticated collaborative operational models by outsourcing stages of production in various locations such that business-to-business intermediate trade now accounts for over two-thirds of the goods and nearly three-quarters of the services traded worldwide.<sup>132</sup> Still, world trade expansion has slowed dramatically in the last few years to around 2.5% in 2014, below GDP growth, causing concern about whether the trading system remains capable of being a driving force for global growth as it was in the last half of the 20<sup>th</sup> century.<sup>133</sup>

Indeed, as mapped by the E15 Initiative,<sup>134</sup> the institutions and rules governing international trade and investment are complex and, in some cases, outmoded. Negotiations in the World Trade Organization (WTO) have been stymied, as its quasi-universal membership advances divergent visions for its modernization, leaving multilateral arrangements to lag behind market and business realities. As a result, countries have been taking their negotiating strategies and energies elsewhere, leading to a proliferation of bilateral, regional and now mega-regional trade negotiations. While potentially positive for those involved, smaller, poorer and more vulnerable countries often feel left out and unable to access the opportunities presented by an open world economy.

**In sum, the international trade and investment system faces a growing challenge of legitimacy.** Its primary institutions appear stuck and fragmented; core norms intended to guide its operation are perceived as being disregarded or undermined; and the services it provides are increasingly perceived as not up to the task of facilitating desired economic, social and environmental outcomes.

Three features in particular that have historically underpinned the system's legitimacy are widely perceived as being eroded within the shifting landscape described above. First is the bedrock principle of *non-discrimination*, which has guided the construction of a rules-based multilateral framework open to broad participation, ensuring the system has the character of a global public good. Second is the notion that the system is a *means serving larger ends*, in particular the objective of sustainable development but also other societal priorities determined by national polities. Third, the long Doha Round stalemate during a

period of dramatic transformation of the world economy has called into question whether the system remains sufficiently *adaptive and fit for purpose*.

The proposals developed by E15 Expert Groups and Task Forces would go a long way toward reinforcing these three pillars of the system's legitimacy, bolstering its **inclusiveness, synergy with other priorities and effectiveness**:

### Inclusiveness

Four sets of proposals have emerged that would particularly help to reinforce the universality or inclusiveness of the system's benefits. These would help to ensure that the variable geometry made necessary by the complex economic and political landscape of the 21<sup>st</sup> century evolves in a way that encourages the widest possible inclusion of countries in such "clubs" (or key elements thereof) in the near term as well as the progressive integration of such regional and plurilateral arrangements (or key elements thereof) into a growing corpus of non-discriminatory multilateral norms over the medium to long term.

- **RTA Exchange.** The Expert Group on Regional Agreements and Plurilateral Approaches has proposed creation of a comprehensive open analytical and dialogue platform to enhance understanding about RTAs and encourage a dynamic of learning, sharing of best practices and ultimately cooperation among them that can lead to the harmonization and even multilateralization of subsets of their rules over time.<sup>135</sup> RTAs offer a vast reservoir of tested and tried rules that can help advance multilateral rulemaking in critical areas. However, so far, RTA disciplines have not been multilateralized, and typically they extend only to RTA members. They are also not covered by the WTO's dispute settlement system. Expanding the number of countries that apply rules negotiated and applied in the major RTAs would most likely yield great new efficiencies and expand world trade. Plurilateral agreements can be just the right vehicle for enabling a larger number of countries to sign onto tested and tried sets of rules incubated in RTAs. However, it is not yet clear which plurilaterals should be negotiated or how plurilateral talks should be structured so as to enable all countries in the multilateral trading system to benefit from them.

The Inter-American Development Bank, in collaboration with the Asian Development Bank and International Centre for Trade and Sustainable Development are in the process of implementing the RTA Exchange proposal as a dynamic online platform and forum to share information, ideas, experiences and good practices on RTAs; further capacity-building of negotiators to negotiate and implement RTAs and companies to apply RTAs globally; regularly take stock of the general public's views on policies related to RTAs; survey private sector's views on the functioning of RTAs; and further idea-generation to advance convergence and coherence with the multilateral system.

- **Model Investment Agreement.** The Expert Group on Investment has proposed a multi-tiered set of recommendations to streamline and modernize the patchwork quilt of investment agreements around the world. The Group suggests building on the recent changes that have been incorporated in model investment agreements of countries as diverse as Norway and India, as well as the work underway and mandated by the United Nations Financing for Development Conference in Addis Ababa at UNCTAD. Specifically, a consultative process would be launched to develop an updated articulation of the overall purpose of international investment agreements (IIAs). UNCTAD’s recently issued Investment Policy Framework for Sustainable Development could serve as a starting point for this process, which would seek to build common ground on not only the articulation of and set of definitions for this restatement of the purpose of IIAs but also the design of the main elements of a 21<sup>st</sup> century international model agreement, using as building blocks a few of the more recently concluded bilateral agreements and perhaps the prospective US-China bilateral investment treaty that is under negotiation. This new model framework, framed as a best practice open for voluntary adoption, would be a bottom-up way to spur modernization and harmonization of an international investment regime that has become highly complex and in some cases out of date. It could be coupled with an open information exchange platform analogous to that proposed above to stimulate the streamlining of RTAs. Or this “International Investment Agreement Exchange” concept could be incorporated into that platform.
  
- **WTO Code of Conduct for Plurilaterals.** The Expert Group on Regional Trade Agreements and Plurilateral Approaches<sup>136 137</sup> proposed initiating a formal process of negotiations on a “code of conduct” to govern plurilaterals, as proposed a few years ago by the World Economic Forum’s Global Agenda Council on the Global Trade System<sup>138</sup>. Such a code could reassure developing countries that are nervous of having plurilateral agreements foisted on them, and could include several principles and rules:
  - *Principles:* 1. membership is voluntary; 2. the subject of the plurilateral is a core trade-related issue; 3. those participating in plurilateral negotiations should have the means, or be provided with the means, as part of the agreement, to implement the outcomes through capacity building assistance;<sup>6</sup> 4. the issue under negotiation should enjoy substantial support from the WTO’s membership in order for it to be authorized as a WTO agreement benefiting from the organization’s dispute settlement system and other resources; and 5. the “subsidiarity” principle should apply in order to minimize the intrusion of “club rules” on national autonomy.
  
  - *Rules:* 1. only parties to the agreement can participate in WTO dispute settlement and, consequently, cross-agreement retaliation should not be allowed, since it would reduce the incentives to join the agreement; 2. Any WTO Member can participate in the negotiations voluntarily, subject to

demonstrating sufficient capacity to implement the outcomes; 3. the provision of benefits to non-members should not be required, since that would reduce the incentives to negotiate the plurilateral, but should be allowed and encouraged. 4. transparency mechanisms should be built into the negotiations so that exclusiveness could be minimized in order to build trust and interest in it.

- **RTA Multilateral Impact Statements.** The Group also proposed the development of multilateral Impact Statements<sup>139</sup> to encourage the negotiators of regional arrangements to design agreements that would (a) create contestable markets that provide benefits to outsiders as well as participants, and (b) serve as the modular components of a more integrated global trading system. One mechanism for doing this would be for an independent authoritative body—either a think tank or distinguished panel of trade authorities perhaps commissioned by the RTA Exchange described above or the WTO—first to lay out a set of relevant criteria and then to apply these to an analysis of RTAs. Ideally, suitable methodologies and criteria would be widely available, and it should become standard practice for drafts of agreements to be analysed prior to being finalized so that negotiators would be given opportunities to correct major deficiencies.
  
- **Regulatory Transparency.** Transparency alone is a factor that decisively contributes to reducing the magnitude of trade friction. Transparency obligations in the TBT and SPS Agreements are the most far-reaching in the WTO regime. One-stop shops, enquiry points, intervals between the preparation and adoption of measures coming under the aegis of the two agreements constitute important innovations. Regulation, however, extends to areas not covered by the TBT and SPS Agreements. A new, consolidated framework on regulatory transparency should be agreed in the WTO in which:
  - (i) there should be a “mapping” of national mechanisms that are intended to provide transparency with respect to national regulatory processes;
  - (ii) WTO members should notify all adopted measures, whether based on international standards or not;
  - (iii) they should explain the rationale behind their measures (“reasoned transparency”);
  - (iv) they should involve affected parties at an early stage in the process;
  - (v) they should use the reasonable interval between publication and entry into force of a measure to fine-tune regulation so that it represents a balanced trade-off between genuine regulatory concerns and an effort to minimize the resulting trade impact. It bears repetition that this proposal is not limited to trade in goods.

These reforms would have the combined effect of carving a constructive path for the system out of the current “spaghetti bowl” of fragmentation. They could set in motion a self-reinforcing dynamic of **modular multilateralization** in which individual

regional and plurilateral rules are progressively reintegrated at the international level over the next 10 to 20 years, spurred by the parallel forces of bottom-up demand by international business for greater simplicity and top-down spotting of opportunities for progress by trade officials and experts based on structured analysis and dialogue.

## Synergy

The world faces a raft of economic, social and environmental challenges both new and old. Climate change poses a severe, even existential, threat, environmental degradation on land and sea is rampant, 1.3 billion people around the world continue to lack access to energy, another billion do not have access to safe drinking water, 702 million live below the poverty line, unemployment is rising, while hunger, poor health, inadequate access to education, and gender discrimination are among the persistent crippling factors that continue to haunt many.<sup>140</sup> For many commercial actors, moreover, the realities of slowing growth, commodity scarcity and shocks, fragmented labour markets and skill shortages abound. The E15 Initiative has proposed many ways in which the global trading system could be strengthened to maximize its contribution to and minimize the complications it creates for this wider sustainable development agenda. These have been summarized in three of the preceding chapters:

- Boosting global growth and employment
- Accelerating sustainable development in least developed countries
- Combating climate change and other environmental degradation

If the international community were to adopt the reforms outlined in these chapters, it would render the international trade and investment regime a much more potent force for progress on three of the most pressing global challenges of our times. Well beyond promoting coherence in the international bureaucratic sense, these three sets of proposals would enlist the global trading system as a full partner---an accelerator of action---on each, in so doing enhancing the system's relevance and legitimacy for all countries.

Finally, the agenda summarized in the chapter on *Preserving national policy space to make societal choices* would provide a serious response to growing concerns about the political legitimacy of trade accords and institutions among some constituencies and countries concerned about the tension between democratic participation and supranational decision making in general and in the international trade and investment domain in particular. The trading system has moved since the dawn of the Uruguay Round from a process of negative regulation, prescribing what governments must not do vis-à-vis tariffs, to positive regulation around services, intellectual property, investment and so on that spill further and further into the national political space. This has given rise to questions around regulatory

legitimacy in various publics expressing concern around the need to safeguard national preferences, ranging from public health and safety, to workers' rights and the environment, from international trade decision-making. Simultaneously, some developing countries worry that they now have less room than industrialized economies did to pursue active industrial development policies due to the strictures set by the WTO and other FTAs to ensure fair competition outcomes and non-discrimination. The trade regime ignores or downplays these concerns at its peril, and the E15 Expert Group suggestions offer a balanced and constructive path forward.

### Effectiveness

In addition to these concerns about inclusivity and fairness, on the one hand, and synergy and relevance, on the other, perceptions of the system's legitimacy are also hampered by a growing sense that it is no longer up to the task of delivering new rules that reflect the profound economic, technological and political shifts taking place. This perception has been exacerbated by the demise of the Doha Round, which has consumed political attention and energy for the past fifteen years. Policy options have been proposed across a range of E15 Initiative Expert Groups that would boost the delivery and effectiveness of the global trade system by expanding the array of negotiating approaches at the disposal of governments within the WTO as well as widening the set of tools available to generate forward progress beyond such norm-setting negotiations, per se.

**Plurilateral Clubs.** In particular, multiple Expert Groups and Task Forces envisioned self-associating coalitions or clubs of countries coming together to advance specific policy objectives, such as standards, new rules or additional liberalization, arguing that these could advance progress among consenting countries in the near term while being structured to invite multilateralization on a modular, as opposed to single undertaking, basis over time.

Under WTO rules, such "plurilateral" deals are either "closed" or "open." Prominent examples are the Government Procurement Agreement and Information Technology Agreement, respectively. A closed club requires unanimous consent of the WTO membership for it to be subject to WTO dispute settlement and oversight, while an open club can achieve this status only if it extends its benefits to all nations, even those outside the club, on a most favoured nation (MFN) basis. These requirements have had the effect of limiting the WTO as a platform for action by like-minded coalitions of countries on new issues posed by economic, technological or political shifts.

To advance recourse to plurilateral deals, the E15 Task Force on Regulatory Coherence, the Expert Group on the Functioning of the WTO, and the Expert Group on Regional Trade Agreements and Plurilateral Approaches identified the following options:

- **Relax the unanimous consent requirement for the negotiation of closed plurilateral agreements to a threshold of 80% approval of WTO membership.** This approach could then be used to deal with regulatory cooperation issues that are beyond the global trade body’s existing mandate in order to answer the variable demands and needs of its membership in a rapidly evolving trade landscape. Where appropriate, provisions found in RTAs could be transformed into an open plurilateral, providing a “critical mass” of members involved to avoid freeriding.<sup>141</sup>
- **Create a plurilaterals council to monitor and guide these types of deals.** The council would be tasked with elaborating the rules for different types of plurilateral agreements. The council could also pay particular attention to potential impacts for market access on those choosing not to participate.<sup>142</sup>

**Informal or “Soft Law” Approaches.** On many challenges, considerable progress can be achieved without the negotiation of formal norms. The trading system could make much wider use of dialogue, analysis and capacity building to expand effective market access.

- **Advance trade facilitation and customs modernization via RTAs.** RTA participants can expand trade with outsiders through trade facilitation, customs modernization and improvements to trade-relevant infrastructure. Such measures have the potential to realize significant global trade gains and represent low hanging fruit in political terms.
- **Boost the use of best endeavour arrangements.** To ensure that “best endeavour” provisions play a positive role in international agreements, the nature of the economic or other conditions justifying a soft law approach should be spelled out, and in appropriate cases technical assistance should be a component in a transition away from soft law towards hard law. Best endeavour commitments should be accompanied by accountability duties, involving specific notification and monitoring provisions, especially if they risk creating misaligned expectations as to the effect of commitments contained in soft law texts.
- **Create a Global Value Chain Partnership.** The E15 Global Value Chain Expert Group has made concrete proposals that could be combined in **a new international public-private platform to improve the efficiency and inclusiveness of global supply chains.** This platform would be aimed fundamentally at helping to increase practical cooperation between countries seeking to integrate their economies into international supply chains and the

companies and experts who could be their partners. The action orientation of the partnership would be underpinned by important new analytical efforts to map existing value chains and impediments to their expansion in new geographies as well as to assemble evidence and examples of good practice that can inform countries of how to maximize the contribution to sustainable development of their participation in global and regional value chains. The global trading system does not currently have a platform dedicated to gathering insights on how GVCs might offer a path to economic development. The platform could be a major focal point of a new Aid for Trade initiative plank targeting funding and technical assistance for improving countries' institutional aspects of enabling environments to help effectively function and integrate into global supply chains. In this context, a Research Center on Global Value Chains (RCGVC) in Beijing was launched in the fall of 2015 with participation and support from a wide international set of academic and international institutions, including the OECD and ICTSD.<sup>143</sup>

- **Develop a digital dispute settlement mechanism.** The digital economy offers strong growth potential. A World Bank study found that a 10% increase in broadband penetration resulted in a 1.38 increase in growth in developing countries and a 1.21% increase in growth in developed countries.<sup>144</sup> But the barriers to digital trade in the context of the current global trade system are many and, from a systemic perspective, particularly include the difficulty of legal redress for digital trade disputes. Digital commerce is expected to increase trade in low-value goods, over which lengthy legal battles in existing national courts or the WTO's dispute settlement mechanism do not make economic sense. Some players have already responded to this challenge, such as EBay's dispute settlement process that resolves more than 60 million online disputes annually, or the OECD's 2007 Recommendations on Consumer Dispute Resolution and Redress. A potential digital dispute settlement mechanism could be established at the WTO to consolidate approaches or, alternatively, WTO members could focus on national efforts and coordinating policies where needed.

**Scale domestic economic institution building assistance.** An assertion of the E15 Initiative Expert Group on Finance and Development is that economic institutions are the key determinant of economic growth and development, and that policy-makers and developing country governments dealing with trade and finance must concentrate on “getting the institutions right”. E15 Initiative Expert Groups outline a number of options where the system could and should be reoriented to integrate trade and institutional capacity building assistance on a much greater scale. This is one of the most important shifts that needs to take place within the system in order for it to meet expectations. Examples include:

- **Use Aid for Trade funding for services.** Given the significant economic importance of services, WTO members should emphasize the need to use multistakeholder initiative Aid for Trade funds towards country-specific studies in order to address policy and regulatory failures around services trade in recipient countries. Dedicated sessions within the WTO should focus on this topic. Diagnostic studies by the Enhanced Integrated Framework should concentrate on services policy and regulatory studies.

- **Improve technical advice on international economic agreements, including public-private partnerships and sovereign debt contracts.** This would go a long way to addressing some of the key infrastructure funding gaps needed to better link low-income countries to markets. E15 Initiative Expert Groups therefore propose expanding, including through financial support, the access of developing country governments to world-class, independent and low-cost advisory legal resource to help negotiate and design public-private partnerships (PPPs); develop an internationally recognized model PPP framework; and provide technical resources to support the development of a clear general legal framework.
- **Ensure correspondent-banking availability.** Banks have dramatically cut down on correspondent-banking networks as the costs of regulatory checks have outpaced business growth potential. As a result, it is feared that some nations are on the verge of exclusion from international financial networks.
- **Enhance institutional monitoring.** Alternative indicators, beyond those already used by institutions such as the World Bank, could be constructed to measure countries' "enabling environments". Based on the weaknesses in country-specific trade and finance characteristics identified by the E15 Initiative in this area as relevant to trade and investment, the constituent elements of this new index could be the following: a Herfindahl index of concentration in the banking sector; the existence of a functioning antitrust authority; an indicator of fluidity of visa policy, including the ease of obtaining a short-term visa; the number of correspondent foreign banks; the existence of a national or regional credit bureau and/or a rating agency; the legal system under which sovereign bond issuance takes place.

**Bolster transparency.** Another suite of policy options addresses issues related to improving both internal and external transparency:

- **Ensure more systemic data management.** One of the challenges is how to organize, present and disseminate the wealth of available trade-relevant information. The WTO should serve as a key information hub on regulatory matters and more resources should be devoted to data compilation, statistics and data management.
- **Generate better data on subsidies through a consortium of universities/independent think tanks and improve agriculture monitoring.** At present, data on subsidies is sparse, ad hoc and unreliable. Subsidies have a significant trade-distorting potential and information asymmetries in this area seriously complicate the efficient functioning of markets. A coalition of universities and independent think tanks around the world could help to obtain additional information on national subsidies using common standards and definitions with graduate students and researchers seeking out data. Improvements to

monitoring agriculture subsidies, in particular, have been proposed during the Doha Round trade talks. One option that would require little in the way of formal negotiations would be to expand the amount of information included in the TPRM's regular country Trade Policy Reviews.<sup>145</sup>

- **Establish a Transparency Agreement.** Transparency is discussed in various agreements in a scattered manner and should instead be consolidated into one agreement including new efforts to bring together the trade and regulatory communities. WTO members should be required to provide *ex ante* evaluations of the trade impact of their regulation and explanations about measures to be adopted.

**Reduce the deliberative deficit.** A key way to tackle difficulties encountered in the multilateral negotiations is to deepen dialogue as a way to build trust and understanding. The WTO secretariat could contribute to reducing a “deliberative deficit” by addressing current topics, suggesting areas for discussion, proposing approaches, analysis and dialogue with other relevant international organizations and within its own Committees as a place for ongoing dialogue among governments and other stakeholders.

- **Engage business and civil society directly.** As the main actors behind international trade, commercial players have an important stake in the global trade body's performance, and the support of the business community is important for the legitimacy of the system. Although processes sometimes exist at the national level for stakeholder input, more engagement at the multilateral level is needed, which could be achieved through the continuation of a formal Business Forum or the creation of a Business Advisory Council. Should the latter approach be adopted, a similar body could be envisaged to channel different civil society voices on key trade-relevant issues.<sup>146</sup>
- **Improve knowledge tools and focus.** The global trading system has suffered from a dearth of empirical methodology around value added in international supply chains. Efforts are under way to correct this information shortfall, with the WTO and OECD collaborating to create a Trade in Value Added (TiVA) database, which allows governments and analysts to better understand trade linkages in an interdependent globalized economy and the real value added that various countries actually generate in trade flows. The TiVA database should be continued on a permanent basis and efforts made to improve the quality of national data. A horizontal work programme on GVCs could also be established at the WTO to explore areas where trade disciplines might be adjusted.<sup>147</sup>

## The Future of the WTO

The foregoing analysis and agenda has major implications for the future role of the WTO, which is in something of an existential crisis as a result of the Doha Round's failure. In agreeing to disagree at the Nairobi ministerial meeting, member governments officially recognized the reality that the terms of reference of those negotiations---the particular combination of topics mandated by the Round---do not command a consensus. But they reaffirmed that the various *individual* Doha Round issues remain open for discussion and possible agreement in other ways and in possible combination with other issues.

Many have speculated that the Doha stalemate means the WTO's negotiating arm is broken and consequently the institution is destined to fade slowly into irrelevance as regional and plurilateral arrangements proliferate. However, the E15 proposals imply an alternative future for the WTO, one in which it plays a more strategic and vital role for the international economic order than ever.

In this alternative future, trade ministers and WTO ambassadors as well as the institution's secretariat embrace the wider global trade and investment ecosystem of rules and institutions. Rather than seeing this complex variable geometry as an intrinsic threat or even rival, they conceive of the WTO as fundamentally embedded in rather existing above or apart from it. They see the institution *servicing* the wider ecosystem, assuming a greater sense of responsibility for its positive evolution through the execution of an expanded array of leadership functions.

Partly because of its origins in the GATT as a framework of negotiated concessions, the WTO's institutional mandate and capacities are focused fairly narrowly on those formal norms. By design, its institutional culture is inward looking – it is the custodian of multilateral rules arrived at through multilateral negotiations. This remains a critical function, but the international community requires more from the WTO in the 21<sup>st</sup> century given the transformation in the world economy and political economy of trade over the past generation.

With the growing fragmentation of the global trade and investment system, the WTO must see itself at least as much as the custodian of these underlying principles as it is of the multilateral norms for which it has formal negotiating and adjudicatory responsibility. Only if the institution's role is broadened from that of a framework for negotiations of reciprocal concessions and the settlement of disputes thereunder to *an enabler of the wider system's contribution to cross-border trade- and investment-related economic development* will the comprehensive set of opportunities for global trade summarized in the preceding chapters be realized and the fundamental legitimacy of the system be assured.

This larger purpose will require the WTO itself to cultivate a wider and more capable geometry of functions in two domains: informal normative and facilitative cooperation; and formal norm creation.

**Informal cooperation.** There is much more the WTO could and should be doing in the areas of data, transparency, analysis, dialogue and facilitation of both normative coherence and expanded trade and investment flows in the service of economic development. It is through the enhanced exercise of these informal or “soft law” functions that the WTO has the most immediate opportunity to further its principles and buttress the legitimacy of the system. For example, the Functioning of the WTO and other E15 Expert Groups have proposed:

- *Strengthening the role of WTO Committees*, making them active platforms for deeper analysis and more productive *informal* dialogue. This would entail extending the terms of Chairs and Vice Chairs from one to two or three years and empowering the corresponding secretariat directorates to be more proactive and independent in the structuring of their research agendas. There are multiple opportunities for the WTO to influence the course of national policy and even regional and plurilateral arrangements in this way. The Trade in Value Added (TiVA) project is a promising example on which to build. Research and informal dialogue on servification, the development impact of value chains and new issues raised by digital trade could help to build understanding and trust among member governments in ways that translate into better and more coherent policies even in the absence of these issues finding their way into formal WTO negotiating mandates.
- *Leading or otherwise participating actively in informal facilitation initiatives*, such as the Global Value Chain Partnership and possible Services and Investment Facilitation frameworks as summarized above. These initiatives and others like them would combine evidence-based dialogue among governments, businesses and experts with the possibility of institutional capacity building assistance for developing countries that spot opportunities for progress and wish to capitalize on them. As such, they have the potential to be just as catalytic of trade and investment flows as formal new trade agreements.
- *Leading or participating actively in informal coherence (anti-fragmentation) initiatives*, such as the RTA and Investment Agreement Exchanges as well as the enhanced regulatory transparency platform described above. These exercises and others like them seek to create an open-source dynamic of transparency, peer exchange, learning and reform. They can be a powerful force for improved consistency, convergence and ultimately the integration of regional and plurilateral arrangement rules into an ever-expanding core of multilateral disciplines. As the guardian of non-discrimination and the global trading system’s fundamental character as a public good, the WTO must become more creative, pragmatic and proactive in advancing this aspect of its mission. This is the kind of institutional leadership that could pay dividends in a decade’s time in the form of a steady, modular multilateralization of rules first negotiated in regional FTAs and sectoral plurilateral agreements.

**Formal norm creation.** The WTO would stand a better chance of catalysing the progressive reintegration of the system over the next 10 to 20 years through the modular multilateralization of specific features of RTA and plurilaterals if it was similarly creative and pragmatic about its negotiating function. Specific E15 Expert Group ideas in this respect include:

- Encouraging the creation of plurilateral clubs that are consistent with this long term objective, in particular by making them eligible for WTO dispute settlement if approved by only 80% of members (rather than the usual consensus) if they are:
  - Open to participation by all members during the negotiating process.
  - Extend their benefits to least developed economies on an unconditional MFN basis.
  - Allow for the extension of benefits to other countries on a conditional MFN basis (i.e., they are open to accession by all countries).
  - Include an institutional capacity building assistance feature to assist interested developing countries.
- Adopting a general code of conduct for plurilaterals.
- Conducting a Multilateral Impact Statement on all proposed and negotiated plurilateral agreements.
- Proactively identifying and proposing for negotiation as a result of its own analysis specific best practice features of RTAs and plurilaterals that may be ripe for broader integration, whether through adoption by other RTAs or a global plurilateral.

By embracing and adapting itself in these ways to a world of variable geometry, the WTO could help to steer the evolution of trade and investment liberalization, most of which now occurs outside the WTO, in a direction that ultimately strengthens the global trading system's legitimacy, rather than undermines it. In view of the system's current trajectory, a more creative and assertive WTO along these lines is what could make the difference between a world of competing, trade-diverting blocs in which many developing countries fall further behind, and one in which the essential MFN nature of the system is rejuvenated and a virtuous circle of balanced integration across advanced and developing countries leads to mutually reinforcing progress in broad living standards for all.

The trade community and WTO would do well to learn from the recent experience of their climate change counterparts. It took the failure of negotiations in Copenhagen in 2009 for the UNFCCC to recognize that a near-exclusive focus on its own formal normative machinery was handicapping its effectiveness as an agent of progress. The negotiations in Paris in 2015 succeeded because the organization and key constituent governments embraced a wider, variable geometry of

opportunities for progress –formal and informal, public and private—and steered them toward an integrated contribution. While the results were only partial, they nevertheless were significant. And they created a blueprint for the construction of future, additional progress.

The first step on this journey was for the UN system to acknowledge that it was just part, albeit an important part, of a wider ecosystem or cooperative architecture. The second was for it to think carefully through how it could exert leadership even on the aspects that were outside its formal competence (e.g., finance, innovation, private sector initiatives, etc.). Through the Durban and Lima ministerials, it put in place the building blocks of this wider cooperative geometry, much of it informal (voluntary national commitments, voluntary private commitments, peer review and verification, etc.).

The agenda outlined above, derived through an extensive process of multistakeholder consultation and ideation, is an analogous blueprint for adapting the WTO and the global trade and investment system to changed circumstances. By embracing the wider trade and investment cooperative ecosystem, assuming a broader role for enabling balanced progress within it, the WTO has a similar opportunity during its forthcoming “period of reflection” to develop a long-term plan to restore its relevance and safeguard the system’s legitimacy. The international community is counting on it to succeed.



## Table of Policy Options

*Note: Policy Options may be important for several primary macro-policy objectives, and discussed in more than one chapter. This table reports several repeated options only once.*

### Boosting Global Growth and Employment

#### Diffusing Technological Progress

Services Single Windows	Create comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing and other administrative requirements.
Liberalized Data Flow	Allow the free flow of data across borders subject to an exceptions provision based on GATS Article XIV (right of countries to protect the privacy of personal data); include an explicit commitment to eschew data localization requirements.
Digital Best Practices	Adopt best practices regarding intermediary liability, privacy, intellectual property, consumer protection, electronic signature and dispute settlement.
Moratorium on Duties for Electronic Transmission	Make permanent the moratorium on customs duties on the electronic transmission of products.
Digital Trade Agreement	Initiate negotiations to establish a Plurilateral Digital Trade Agreement or “eWTO”.
ITA Expansion	Expand the Information Technology Agreement
Digital Trade Working Group	Create a WTO Working Group on Digital Trade supported by a technical advisory committee of private sector and academic experts.
GATS Clarifications	Clarify GATS commitments given the convergence in basic and value added telecommunications services.
Telecoms Reference Paper	Clarify the terms of the WTO Telecoms Reference Paper especially in reference to the internet.
Work Programme on Electronic Commerce	Provide direction to the Work Programme on Electronic Commerce if that process does not yield progress at the Nairobi ministerial meeting.
Digital Trade Policy Review	Create a Trade Policy Review Mechanism (TPRM) framework to analyse the consistency of country measures affecting digital trade with their WTO commitments.

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R&D Services Liberalisation	Include research & development services in GATS
Basic Science & Technology Agreement	Establish a WTO Agreement on Access to Basic Science and Technology to strengthen the global commons in science and technology without unduly restricting private rights.
<b><i>Improving the global efficiency of capital &amp; skills allocation</i></b>	
Financial Services Cooperation	Deepen regional regulatory cooperation in financial services by: 1) creating regional mechanisms, such as regional credit bureaus and rating agencies; 2) facilitating free data flows and offshoring; 3) standardising documents and documentation requirements.
Temporary Movement of People	Allow the temporary movement of natural persons across frontiers to provide services by streamlining processes related to visas and work permits by: 1) clarifying how GATS provisions apply to visas and work permits procedures; 2) Improving transparency; 3) Strengthening regulatory cooperation for managing the entry and stay of natural persons for the supply of services.
Innovation Zone Plurilateral	Establish a plurilateral but open “innovation zone” through GATS within which skilled researchers and technical personnel can migrate freely for up to 10 years.
<b><i>Expanding Trade &amp; Investment in Employment-Intensive Industries</i></b>	
Services Facilitation	Develop a comprehensive WTO Framework for Trade Facilitation in Services with: 1) intensified temporary and short stay visa facilitation; 2) enhanced access to finance for trade in services; 3) common guidelines for the governance of electronic trade and cross-border data flows; 4) benchmarking of best practices and development of regulatory principles to address cross-border market failures in services sectors.
<b>Reducing Commercial Friction and Investment Uncertainty</b>	
<b><i>Global Value Chain Partnership</i></b>	
GVC Platform	Create a new international public-private platform to improve the efficiency and inclusiveness of global supply chains comprising: 1) Supply chain councils to carry out mapping studies of supply chains and their constraints, 2) Development implications analysis to assist national strategies, 3) Informed capacity building and interactions to strengthen the enabling environment.

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***Rationalizing preferential trade agreements and investment agreements***

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RTA Exchange	Create an RTA Exchange, a comprehensive open information platform to enhance understanding of RTAs, sharing of best practices and ultimately harmonization/multilateralization.
Model Investment Agreement	Create a model investment agreement, formulated as a best practice open for voluntary adoption to help modernise and harmonise the international investment regime; create an International Investment Exchange

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***Coordinating services, competition, data transmission, IP and other aspects of regulatory cooperation***

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Services Soft Law	Utilize best-endeavour clauses, accompanied by monitoring and assistance, to create momentum in services trade agreements where hard law commitments may not be feasible in the near term
Services Trade Restrictiveness Index	Continue and expand the OECD Services Trade Restrictiveness Index.
Goods/Services Integration	Integrate goods, services and investment in trade policy by deepening the Trade in Value Added research of the OECD and WTO and establishing a WTO Working Group to recommend ways to reduce distortions resulting from the separate rules for goods and services
Regulatory Transparency	Strengthen the transparency of national regulations: 1) map national transparency mechanisms; 2) have WTO members notify all adopted measures, whether based on international standards or not and explain the rationale behind them (reasoned transparency); 3) have a reasonable interval between publication and entry into force of a measure to fine-tune regulation.
Common Regulatory Objectives	Expand the use of the Common Regulatory Objectives model as advanced by Recommendation L of the UN Economic Commission for Europe
Business Participation	Provide observer status to business in the WTO TBT, SPS and other Committees.
Competitive Neutrality	Build upon the competitive neutrality principles for state-owned enterprises included in the Trans-Pacific Partnership and EU-Canada CETA agreements
Competition and Trade Cooperation	Improve cooperation among competition and trade policy authorities.

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Digital Single Windows and APIs	Adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to link SMEs to large numbers of country single windows. Help finance in developing countries through Aid for Trade.
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Customs de-minimis	Establish higher, standardized de-minimis customs levels to facilitate cross-border flows of small packages supplied by internet-enabled retail services providers, especially SMEs.
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Postal Services Integration	Explore the integration of national postal services into an interoperable, global, package-shipping network.
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**Accelerating Sustainable Development in Least Developed Countries**

***Maximising preferential market access***

Duty-Free, Quota-Free	Developed countries should extend full DFQF market access for all LDCs. Middle-income countries should implement DFQF programmes that attain 97% tariff line coverage. Both groups should implement rules of origin for these preference arrangements using an extended cumulation approach, forming a broad cumulation zone.
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Agricultural Solidarity Fund	Create a solidarity fund to which financial contributions would be made in proportion to the magnitude of Official Trade Distorting Support for agriculture.
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***Improving the terms of foreign investment***

Regional Platforms for Excellence.	Create regional platforms to clarify global regulatory initiatives and market developments and help with value-chain upgrading efforts.
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***Increasing the volume of financing for trade-related development***

Correspondent Banking	Ensure correspondent-banking availability in developing countries by: 1) Mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group to improve local banks’ governance structure; 2) Have the mentor validate the “Know your Customer” process at the local bank; 3) Compel a minimum service correspondent-banking network for each enabled country and chosen banks.
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Aid for Trade Expansion	Increase aid directed to investment-climate institution building. Target aid to the development of rules and administrative and adjudicatory capacity in the areas of services, legal and regulatory reform, investment frameworks, private standards adherence, responsible supply chain practices, global value chain mapping against domestic capabilities and anti-corruption.
Tax Reforms	Increase domestic resource mobilization in developing countries through capacity-building assistance for stronger domestic tax institutions and a more transparent international tax system.

***Ensuring inclusivity of norm setting and adoption***

Standards Capacity-Building	Provide assistance to apply SPS & TBT conformity testing. Scrutinize private standards. Support the Standards and Trade Development Facility.
Regional & Plurilateral Inclusivity	Devise principles by which the emerging mega-regional regime can connect more easily with the multilateral system. Extend benefits from mega-regional agreements to LDCs.
Institutional Readiness Index	Create an Institutional Readiness Index to guide LDCs and development partners in setting priorities for the support of economic institution building.

**Increasing Economic Diversification and Competitiveness in Middle-Income Countries**

***Supporting Investment***

Investment Transparency	Host countries, home countries and MNCs to share information on legislation, incentives, contracts, etc.
Strengthen IPAs	Investment Promotion Agencies increase their role in policy benchmarking and advocacy, partnership facilitation, process simplification.

***Establishing a Global Value Chain Partnership***

GVC platform	Create a new international public-private platform to improve the efficiency and inclusiveness of global supply chains comprising: 1) Supply chain councils to carry out mapping studies of supply chains and their constraints, 2) Development implications analysis to assist national strategies, 3) Informed capacity building and interactions to strengthen the enabling environment.
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***Expanding Services & SME Trade***

SME-Friendly Policies	Provide digital single windows for goods and services trade with reduced administrative burdens for low-value trade.
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**Strengthening Regulation & Standards**

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Competition Monitoring	Set up a Global Competition Alert. Empower domestic competition agencies to evaluate their governments trade regulations.
Competition Best Practice & Advocacy	Increase interactions between competition agencies. Provide technical assistance and best practice strategies.
Soften LCRS	Soften local content rules via broadening to regional economic communities. Require WTO monitoring and conduct analysis of their effects.
Skills & Learning	Invest in human capital and develop centres of excellence to foster learning and quality improvements.
Non-actionable subsidies	Allow subsidies related to R&D, regional development, environmental protection and disaster recovery

**Combating Climate Change and Environmental Degradation**

**Climate Change**

Regime coherence	Arrange systematic coordination between the UNFCCC & WTO. Define “climate measures” for the purpose of trade dispute settlement. Promote dispute settlement under the UNFCCC. Uphold IMO & ICAO climate agreements in the WTO.
Enabling Frameworks	Establish carbon accounting standards. Allow for WTO-plus climate clubs. Clarify WTO treatment of emissions trading systems. Address consumption-based carbon accounting.
Energy Transition	Eliminate fossil fuel subsidies. Cut tariffs on environmental goods and services. Limit antidumping actions against clean energy technologies. Allow for clean energy subsidies. Clarify trade rules for electricity transmission.

**Natural Resources & Extractives**

Sectorial agreement	Develop a stand-alone trade agreement on finite natural resources. Improve investment agreements in the sector, targeting transparency and environmental standards.
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**Fisheries and Oceans**

Fisheries Management	Discipline fisheries subsidies. Tackle IUU fishing through traceability requirements, stock reporting and private sector schemes.
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**Ensuring Food Security**

**Establishing an equitable and predictable multilateral trade system;**

Confidence Building	Rebuild trust through non-binding measures, particularly on domestic support.
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Agriculture Plurilateral	Initiate negotiations on a plurilateral agreement on agriculture.
<b><i>Ensuring stable food availability and accessibility in times of high and volatile prices;</i></b>	
Disciplining export restrictions	Progressively, exempt humanitarian aid from export restrictions, clarify current disciplines, and ultimately, with exceptions, prohibit export restrictions and taxes.
Public Stockholding	Update price references for public stockholding schemes
Food Market Transparency	Provide stockholding data to the Agricultural Market Information System
Emergency Reserves	Establish emergency humanitarian food reserves
Global Food Stamps	Provide international help with the design and funding of social safety nets.
<b><i>Delivering public goods while addressing trade distortions;</i></b>	
Green box reform	Distinguish between payment for public goods and income support, cap income support and provide more transparency on green box measures.
Biofuels support	Notify biofuels support measures and design disciplines, potentially by expanding the Agreement on Agriculture
Food & Climate	Minimize trade distortion through green box measures, support agricultural productivity in LDCs and clarify the conditions for border carbon adjustments.
<b><i>Promoting value addition and export opportunities.</i></b>	
Facilitating Agricultural Trade	Develop regional trade facilitation plans for agriculture, including infrastructure and trade financing.
Harmonization	Increase use of international standards in domestic SPS regimes, multilateralize standards transparency provisions adopted in RTAs and provide SPS capacity building.
Private standards	Use oversight, guidelines and public pressure to drive inclusiveness in private standards and support compliance with such standards via Aid for Trade
Agri-Food negotiations	Address seeds, pesticides, fertilizers, logistics and other inputs in an integrated manner in agricultural negotiations.

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<b>Preserving National Policy Space to Make Societal Choices</b>	
<b><i>Supporting Industrial Development</i></b>	
Update IIAs	Modernize and strengthen the coherence of investment agreements through 1) a consultative process to update the overall purpose of IIAs; 2) design a model 21st century investment agreement including investor obligations, appeals framework, public participation; 3) create an Advisory Centre on International Investment Law; 4) extend Aid for Trade to cover investment issues; 5) use the model agreement to create a plurilateral investment agreement
Non-Actionable Subsidies	Create a safe harbour for subsidies to address market failures for climate change, regional development, R&D, natural disasters and conflict
<b><i>Protecting Societal Values</i></b>	
Plurilateral Regulatory Cooperation.	Engage like-minded countries in open clubs that establish a common floor for social and environmental standards and encourage other countries to join by extending trade and investment preferences and substantial capacity-building assistance.
Responsible Supply Chain Practices	Marshal a concerted approach to build a critical mass of corporate adherence to sustainable product and supply chain practices.
<b>Strengthening the Legitimacy of the Global Trading System</b>	
<b><i>Inclusiveness</i></b>	
RTA Exchange	Create an RTA Exchange, a comprehensive open information platform to enhance understanding of RTAs, sharing of best practices and ultimately harmonization/multilateralization.
Model Investment Agreement	Create a model investment agreement, formulated as a best practice open for voluntary adoption to help modernise and harmonise the international investment regime; create an International Investment Exchange
Plurilateral code of conduct	Negotiate a code of conduct governing plurilaterals in the WTO
RTA Impact Statements	Provide for RTA impact statements to encourage multilateral compatibility and contestable markets.

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Transparency of national regulations	Strengthen the transparency of national regulations: 1) map national transparency mechanisms; 2) have WTO members notify all adopted measures, whether based on international standards or not and explain the rationale behind them (reasoned transparency); 3) have a reasonable interval between publication and entry into force of a measure to fine-tune regulation.
<b><i>Effectiveness</i></b>	
Plurilateral Clubs	Relax the conditions for plurilateral agreements but provide for monitoring and guidelines.
Informal Approaches	Boost the use of best endeavour approaches, advance practical implementation, create a GVC partnership platform and develop digital dispute settlement mechanisms.
Domestic Institution Building Assistance	Improve technical advice for contracting, enhance institutional monitoring, ensure correspondent banking availability and provide aid for services trade.
Bolster Transparency	Expand the WTO's role as an information and data hub, with stronger reporting requirements on members
Deliberative Deficit	Engage business and civil society more directly in the WTO and improve knowledge tools and focus.

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  79. See Hausmann, 2013, slide 37, available at <https://www.imf.org/external/np/seminars/eng/2013/SPR/pdf/Rhs.pdf>
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- 88a. The following text draws on that Think Piece.
- 88b. See in this context also the United Nations Sustainable Development Goals (UNGA 2015). Goal 17: “Strengthen the means of implementation and revitalize the global partnership for sustainable development” with target 17.5: “Adopt and Implement investment promotion regimes for least developed countries.”
- 88c. It should be noted, however, that a sustainable investment support programme as advocated here places special emphasis on the promotion of sustainable FDI and maximizing its benefits.
89. Milberg and Winkler, 2013

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90. See Singh and Jose, forthcoming. For more details, see the studies referred to therein, such as Agénor and Canuto, 2012; Aiyar et al., 2013; Eichengreen et al., 2013; Harrison and Rodriguez-Claire, 2010; Lin and Treichel, 2014; and Nubler, 2014.
91. For good governance, Salazar-Xirinachs et al. (2014) emphasize the importance of accountability, applied to both private actors and the state, automatic sunset clauses, built-in programme reviews, monitoring and the establishment of clear benchmarks for success or failure, and periodic evaluation exercises (p. 31).
- 91a. In some countries, the trade and investment promotion functions are combined in one agency. Even in the absence of an investment support programme, it would make sense for the trade and investment focal points at the national level to cooperate.
- 91b. See in this context also OECD (2015b).
- 91c. There are also other international organizations that could bring their expertise to such an effort, for example the ILO with its important focus on decent work and inclusive growth, as well as its experience with its Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (ILO 2006); the Office of the High Commissioner for Human Rights with its work on the Guiding Principles for Business and Human Rights (UN OHCHR 2011); and UNEP with its experience in environmental matters.
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- 96a. Porges and Brewer, 2013
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- 96h. See, for example, “Canada – Certain Measures Affecting the Renewable Energy Generation Sector”, WT/DS412/AB/R; “Canada – Measures Relating to the Feed-in Tariff Programme”, WT/DS426/AB/R; “India – Certain Measures Relating to Solar Cells and Solar Modules”, WT/DS456; or “China – Measures Concerning Wind Power Equipment”, WT/DS419
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97. The World Food Summit of 1996 defined food security as existing “when all people at all times have access to sufficient, safe, nutritious food to maintain a healthy and active life”.
98. Laborde, 2014
99. Ernst & Young, 2013
100. See Bureau and Jean, 2013
101. OECD/FAO Agricultural Outlook, 2013
102. Schmidhuber and Meyer, 2014
103. According to the “OECD-FAO Agricultural Outlook 2015-2024”, prices for all agricultural products are expected to decrease over the next 10 years with productivity growth and low input prices outpacing demand increases, but will remain at a higher level than in the years preceding the 2007-2008 price spikes.
104. According to Martin and Anderson (2011), in the 2006-2008 surges, insulating policies affecting the market for rice or wheat explain 45% and 30%, respectively, of the increase in the international rice price.
105. See FAO, IFAD and WFP, 2015
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107. According to Nelson et al. (2009) at the International Food Policy Research Institute, developing countries’ agricultural imports might double in 2050 compared to the 2000 baseline, due to climate change.

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108. In the European Union, the new Common Agricultural Policy increasingly requires farmers to respect additional environmental requirements as a condition for receiving support. In the United States, the new 2014 Agriculture Act abolishes direct payments to producers – seen by many as impossible to justify politically when prices are high. In their place, Washington has introduced subsidized insurance programmes for price and revenue with significant trade distorting potential (Glauber and Westhoff, 2015).
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Policy Options Papers



The **E15** Initiative

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This full volume of policy options papers covering all topics examined by the E15Initiative is complemented with a synthesis report that consolidates the options into overarching recommendations for the international trade and investment system for the next decade. The second phase of the E15Initiative will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

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# Introductory Note

The policy options papers presented in this volume are the result of a collective process involving 14 thematic Expert Groups, three horizontal Task Forces, and an overarching theme looking at the global trade and investment architecture, involving consultations with hundreds of thinkers and policy-makers. Each group has engaged on a broad range of trade-related subjects. The groups were comprised of 20–30 experts—including academics, intergovernmental and non-governmental organization representatives, business representatives, practitioners in international trade law, former diplomats and policy-makers—reflecting a wide range of perspectives and geographies.

Given the cross-cutting nature of many of the issues, analyses, and recommendations, the papers have been ordered alphabetically by theme. However, they can loosely be categorized under the headings below.

New Economy	Global Supply Networks	Sustainability	System Reform	Development
Clean Energy Technologies	Competition Policy	Agriculture & Food Security	Functioning of the WTO	Finance & Development
Digital Economy	Global Value Chains	Climate Change	Global Trade & Investment Architecture*	Industrial Policy
Innovation	Investment	Extractive Industries*	Regional Trade Agreements	
Services	Regulatory Coherence	Fisheries & Oceans	Subsidies	

\* To be released in late 2016

Building on their empirical insights and theoretical knowledge, the experts have outlined ideas and strategies for strengthening the global trade and investment system for sustainable development. The groups had three specific and sequenced objectives:

1. Explore and provide in-depth understanding of current and emerging 21<sup>st</sup> century challenges and opportunities within their theme;
2. Assess the adequacy of the global trade and investment system, including the WTO, to respond to these challenges and opportunities; and
3. Identify and suggest policy options for enhancing the ability of the global trade and investment system to better respond to emerging challenges and promote opportunities.

To fulfil this mandate, the groups met 2–3 times in different venues for formal meetings and deliberations. Through the convening power of ICTSD and the World Economic Forum, the E15 Initiative gave these world-class experts a forum to discuss pressing issues, develop original thinking, and identify forward-looking policy options. As conveners, ICTSD and the Forum selected the leadership within each group, including a Theme Leader and a Knowledge Partner—an institution or organization globally recognized for its expertise and leadership in the theme.

In addition to formal meetings and informal exchanges, the Expert Groups and Task Forces commissioned succinct Think Pieces, mostly authored by group members, on select issues that were considered to deserve additional in-depth analysis, and designed to feed into the dialogue process towards formulating policy options. Outside experts from government, business, and civil society were also invited on occasion to enrich and help validate the ideas.

The Theme Leaders prepared the policy options papers on behalf of their Expert Group or Task Force. The papers were distributed internally for thorough group review. The accompanying Note to the papers makes clear that the options do not represent full consensus given the wide variety of views and the at times contentious nature of the matters at hand.

As Ricardo Meléndez-Ortiz and Richard Samans indicate in the foreword to this volume, the options come in many forms and cover a broad range of issues. A key variable behind many of the options is political feasibility—concrete recommendations that can be implemented in the short to medium term. However, in view of its mission as a strategic project with a vision, the E15 Initiative has also encouraged the generation of proposals of a more aspirational and systemic nature to be considered over a longer time horizon—“North Stars” worth striving towards that may animate discussions on the improved governance of international trade and investment over the coming years.

The papers all recognize the need to ensure that trade and investment policy frameworks advance sustainable development and that multilateral progress in recent years has been slow. However, the assessments vary between groups, some leaning towards a market efficiency approach and others focusing more explicitly on public goods and developmental constraints. Moreover, the papers cover diverse priority areas of relevance to countries at different levels of development. Additionally, while the multilateral trade regime governed by the WTO gathers the attention of much of the policy insights and recommendations, the global trade and investment system is explored across its multiple institutions and layers—from plurilateral to regional and unilateral rule-making as well as informal networks and non-state initiatives. One consideration that virtually all papers bring to the fore—in a world characterized by growing economic interlinkages and sustainability imperatives—is the need for greater coordination and reciprocal engagement between the trade community and outside constituencies, regulatory authorities, policy communities, and regimes.

The papers are structured in similar fashion. Following an introduction and background analysis, the policy options are presented under specific headings, areas for reform, or work programmes. Where appropriate, suggestions concerning the implementation process are outlined. The main options are ordered in a summary table found in annex to the papers. The Expert Group and Task Force members are also listed in annex.

The E15 Initiative has brought together some of the best minds in the world to critically engage on the intricate issues surrounding the governance of international trade and investment in a newly emerging global economic landscape. The resulting policy options offered for consideration in this volume are relevant to policy-makers and stakeholders, including the business community, from developed and developing countries. Their purpose is to work towards strengthening the global trade and investment system in a manner that is responsive to new demands and advances sustainable development.



International Centre for Trade  
and Sustainable Development



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IMPROVING THE STATE  
OF THE WORLD

# Agriculture and Food Security: New Challenges and Options for International Policy

Policy Options Paper



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# Agriculture and Food Security: New Challenges and Options for International Policy

Stefan Tangermann

on behalf of the E15 Expert Group on Agriculture, Trade and Food Security Challenges

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Agriculture, Trade and Food Security Challenges. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Stefan Tangermann was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15Initiative:  
[www.e15initiative.org](http://www.e15initiative.org)

# Abstract

New challenges are facing the global food and agriculture trading system in the 21st century. The present paper identifies options for how policies and international trade rules can respond to this new reality. It is not specifically addressed towards the ongoing negotiations of the Doha Round at the WTO, nor is there any attempt to re-define the mandate for these negotiations. The new challenges include a change in the supply-demand balance in global food and agriculture markets; large-scale use of agricultural commodities as feedstock for biofuel production; heightened market volatility; the impacts of climate change and government response; and important changes in agricultural policy regimes in major producer countries. Against this background, the paper recommends trade policy options in two areas: adapting the WTO Agreement on Agriculture and the Agreement on the Application of

Sanitary and Phytosanitary Measures; and more general WTO rules of particular importance for food and agriculture, especially with regard to environmental measures. It also puts forward options targeted at international cooperation to improve food security and foster agricultural productivity. The changing conditions on agricultural markets over the past decade have brought to the fore the need to improve food security globally. Focusing on this priority can demonstrate what international trade, and the regime governing it, can do for developing countries. At the same time, work must continue towards strengthening competitive markets, removing trade barriers and minimizing policy-induced distortions while providing urgently needed public goods. Policy options that seek to act on these priorities are presented over an indicative short to long-term time horizon.

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Abbreviations	
AIS	agricultural innovation systems
AMIS	Agricultural Market Information System
AoA	Agreement on Agriculture
ASCM	Agreement on Subsidies and Countervailing Measures
CGIAR	Consultative Group on International Agricultural Research
EU	European Union
FAO	Food and Agriculture Organization
G20	Group of Twenty major economies
GATT	General Agreement on Tariffs and Trade
GSP	Generalized System of Preferences
GHG	greenhouse gas
IPC	International Food & Agricultural Trade Policy Council
LDC	least developed country
MFN	most favoured nation
NGO	non-governmental organization
NTM	non-tariff measures
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OTDS	overall trade distorting domestic support
PPM	process and production method
R&D	research and development
SPS	sanitary and phytosanitary
WTO	World Trade Organization

# Executive Summary

Today's global food system is vastly different from what it was when the Doha Round was launched in 2001. Against this background, the E15 Initiative has tasked an Expert Group to explore the challenges facing the food and agriculture global trading system in the 21st century. The objective is to identify options pertaining to policies and international trade rules that respond to this new reality. For this purpose, the International Food & Agricultural Trade Policy Council (IPC) joined forces with ICTSD and the World Economic Forum. The resulting policy options paper, though closely related to the multilateral trade regime, is not specifically addressed towards the ongoing Doha Round at the WTO nor is there any attempt to re-define the mandate for those negotiations. The paper pays particular attention to food security concerns and issues relevant to developing countries.

## New Challenges

Many developments have taken place over the past fifteen years that have transformed the landscape in which international policies for the food and agriculture sector, and in particular trade policies, must operate.

After a long period of declining prices on international markets, the world food system suffered from extremely high prices and pronounced volatility in 2007-08 and subsequent years. More recently, prices have declined but not to the low levels of the early 2000s. Market projections suggest that they will remain for some time on a notably higher level than prior to 2007. This episode of price volatility characterized by successive spikes at short intervals has been caused by factors ranging from extreme weather events and new forms of financial investment to the expansion of feedstock for biofuels and *ad hoc* export restrictions.

Climate change is creating new challenges for the future of global agriculture. It amplifies market volatility and will be marked, in terms of impact, by localized year-to-year variability and spatial differentiation. Governments are increasingly seeking ways to respond to climate change and other environmental issues. Trade policy is one of the domains where solutions are sought yet where tensions between domestic policies and international rules may arise.

Experience with implementing the WTO Agreement on Agriculture (AoA) has pointed at issues that require attention. Some relate to the definition of rules and others with the manner in which governments have chosen to deal with them. Moreover, while disciplines and commitments applicable to agriculture in the WTO have not been modified since the completion of the Uruguay Round (1986-94),

actual policies in many countries have evolved. Major developed countries have shifted toward more market-oriented approaches, with changes in the structure of support, while trade distorting measures in a number of emerging and developing countries have tended to rise.

## Policy Options

The paper considers trade policy options in two areas: adapting the AoA and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures; and more general WTO rules of particular importance for food and agriculture. It then puts forward options targeted at international cooperation to improve food security and fostering agricultural productivity.

### *Adapting the Agreement on Agriculture and the SPS Agreement*

Progress is needed on all three pillars of the AoA (market access, domestic support and export competition). In addition, international trade rules should be symmetric for importing and exporting countries: disciplines should apply to exporting countries that discriminate in favour of domestic users; greater transparency regarding restrictions would benefit the smooth functioning of markets; a procedure should be established to identify whether an exporting country actually has reason to adopt a restriction in order "to prevent or relieve critical shortages of foodstuffs"; shipments destined to serve as food aid in an emergency should be excluded from restrictions; and export taxes should be bound in the same way as tariffs are.

Regarding biofuels, there is a clear need to create more transparency regarding the types and levels of government support. Additionally, the establishment of effective disciplines could be introduced, with commitments on biofuel support aimed at constraints on the burden that is placed on food consumers.

Notifications of Green Box measures should provide more detail on the implementation of the policies concerned so that their potential trade impact can more effectively be assessed. As far as public stockholding for food security purposes is concerned, it is doubtful whether rational policy pursuit is helped if a direct link is established between this consumer-oriented policy and support for certain producer groups. In addition, it appears sensible to distinguish in the Green Box between policies aimed at the provision of public goods and measures targeted at income support to farmers. The former should remain unconstrained while a cap could be introduced on the latter. Moreover, monitoring and surveillance of agricultural policies should be strengthened

through provisions such as those suggested in the draft Modalities of December 2008. Finally, new incentives for compliance could be created if the assumption of ineligibility for benefits (e.g. excluding Green Box measures from reduction commitments) were introduced until eligibility has been affirmed based on notifications.

The functioning of the SPS Agreement would benefit from a more effective notification system and new incentives to make more ample use of international standards. Developing countries should receive assistance through a strengthened Standards and Trade Development Facility. The relationship between private and public standards should also be clarified.

### *Preparing WTO Rules for the Future*

As governments design policies that lead farmers in the direction of engaging in practices that are more environmentally friendly, while also developing approaches that make agricultural production more resilient to the impacts of climate change, it is probable that there will be a tendency to underpin restrictive domestic policies with complementary measures that operate at the border. These could take the form of tax adjustments and the extension of standards. The conditions under which WTO rules permit the use of border adjustment measures need to be clarified, as they are intended to prevent cross-border trade from undermining the effectiveness of domestic policies targeted at climate change and the environment.

### *International Cooperation to Improve Food Security*

Improved market transparency, for example through support for the new internationally co-ordinated Agricultural Market Information System, can help reduce difficulties in obtaining access to supplies. This implies a commitment to provide data, especially on public and private stockholding. In addition, international assistance for the creation of emergency reserves, and for the establishment and implementation of social safety nets, could improve the capacity of poor countries to deal with episodes of surging food prices.

The international community should further consider creating a new instrument of financial solidarity. This could come in the form of an agreement in which developed and emerging countries would provide financial support for measures aimed at improving food security and fostering agricultural development in low-income countries. Contributions would be made in proportion to the magnitude of their overall trade distorting domestic support (OTDS). This innovative approach would constitute a direct response, in the context of trade, to one of the biggest challenges to have emerged in the world's food and agriculture sector in recent years.

### *Fostering Higher Agricultural Productivity*

Boosting productivity, specifically in least developed countries, is a promising approach to advance living conditions in rural areas and enhance food security. Investments in agricultural innovation systems should be increased and national governments should work towards the removal of barriers to the adoption of productivity enhancing technologies.

## Priorities and Next Steps

Priorities for policy orientation are shaped by the most pressing challenges of the time. The international community must place a strong focus on improving food security. Doing so will demonstrate what the international trade regime can constructively do for developing countries. At the same time, work must continue towards strengthening markets, reducing trade barriers and minimizing policy-induced distortions while providing urgently needed public goods. The options discussed in this report seek to respond to these priorities.

### *Short-Term Options*

A primary candidate for an early agreement would be a resolve to establish a new instrument of financial solidarity, whereby developed and emerging countries make financial support available in proportion to their OTDS. Other options that can be pursued in the short-term include: more transparency on export taxes and restrictions; exclusion from export restrictions of shipments destined to serve as emergency food aid; more transparency regarding support to biofuels; improved monitoring and surveillance under the AoA; and strengthened support to the Standards and Trade Development Facility.

### *Medium-Term Options*

Options that may require more time include: binding of export taxes as a priority; clarification and amendment of Green Box rules; and improved transparency regarding SPS measures.

### *Longer-Term Options*

Options to be considered over a longer timeframe include: new incentives for compliance with monitoring requirements under the AoA; establishment of disciplines on support for biofuels; and clarification of the conditions under which the WTO permits border adjustment measures. Outside the WTO, the international community should work towards: improved market transparency; support for emergency reserves; assistance for strengthened social safety nets; and measures that foster agricultural productivity.

### *Process*

Consideration of some of the policy options presented in the paper could possibly be included in the work programme on the remaining Doha issues currently discussed among WTO members. Should deliberations result in agreement on any given item before the Doha Round is concluded, that item could, if appropriate, be implemented right away. Alternatively, it can be set aside for later inclusion in a Doha agreement. Elements that require more time for negotiation may reach maturity only after the Doha Round is concluded. Finding agreement on new policy options such as those suggested in this paper would send a positive signal that the international trade regime has the capacity to respond to acute challenges.

# 1. Introduction: What is this Report About?

Today's global food system is very different from that of 2001 when the Doha Round of trade negotiations was launched at the WTO. Food price spikes in 2007-08 and subsequent years have brought food security concerns to the forefront of the policy agenda. The linkages between price volatility and national as well as international policies have come into the spotlight. Growing concerns are arising regarding the world's capacity to feed its still rapidly growing population. Climate change may further aggravate the situation, specifically in less well-off regions of the world where food security is already a major concern. In more affluent countries, growing attention is paid to the impact of agriculture on the environment. Meanwhile, in the trade arena, multilateral progress in the Doha Round is difficult to achieve.

Against this background, the International Centre for Trade and Sustainable Development (ICTSD), in partnership with the World Economic Forum, has tasked an Expert Group, as part of the E15 initiative, to explore the many challenges facing the global food trading system in the 21st century and their implications for sustainable development. The objective is to identify options pertaining to policies and international trade rules that can respond to this new reality. For this purpose, the International Food & Agricultural Trade Policy Council (IPC) joined forces with ICTSD and the World Economic Forum.

The focus of this paper is international trade and the multilateral system underpinning it. National policies directed at shaping domestic food and agriculture sectors will also have to adapt to the changing conditions of the 21st century and may actually have to carry the largest share of the burden. However, given its focus on international trade and multilateral policies, the paper will consider national measures at best in passing. The objective is to identify policy options that can respond to issues that have become increasingly relevant in the past decade or so. While these options, and the deliberations behind them, are related to the international trade regime, they are not specifically addressed toward the ongoing negotiations of the Doha Round; nor is there any attempt to re-define the mandate of these negotiations.

Food security is an issue of primary importance for developing countries. At the same time, the untapped potential of world agriculture is particularly promising in developing countries. Mobilizing this potential requires better integration of their farmers, above all smallholders, into markets. A number of developing and emerging countries are increasingly successful food exporters. However, the rapid growth of incomes and population in many developing countries means that, as a group, they are likely to exhibit increasing food imports. For these reasons, international trade in food and agricultural products is of vital importance to developing countries, as are the multilateral rules governing it. This paper will therefore pay particular attention to issues relevant to developing countries.

The paper begins with a look at the new challenges the global food and agriculture system is facing in the 21st century (Section 2). On that basis, it then considers trade policy options for the future in two areas: adapting the WTO Agreement on Agriculture (AoA) and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures (Section 3.1); and more general WTO rules of particular importance for food and agriculture (Section 3.2). The report also discusses policy options targeted at international cooperation to improve food security (Section 3.3) and fostering agricultural productivity (Section 3.4). It concludes with priorities and a suggested timeframe for policy implementation (Section 4).<sup>1</sup>

<sup>1</sup> References in the report have been kept to a minimum. The overview paper and think pieces produced by the E15 Expert Group, from which this paper draws freely, contain full references. Readers interested in more detail and references to the literature are encouraged to consult these supporting documents.

# 2. New Challenges

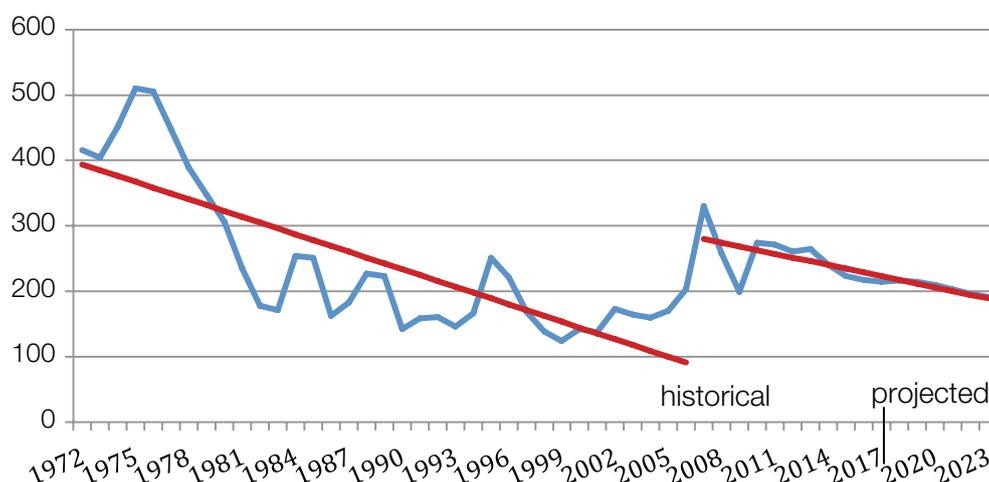
As the world changes, policy frameworks are continuously faced with new challenges. Policies for agriculture and food security are no exception. At the national level, the rhythm of policy adjustments is often dictated by parliamentary elections or specific sunset clauses. At the international level, major negotiating rounds provide opportunities for policy revisions. As far as multilateral trade negotiations are concerned, the launch of the Doha Round in 2001 provided an opportunity to set an agenda for adapting the fundamental rules of the WTO to the needs of the time. Unfortunately, 15 years of negotiations have not brought closure to the Doha Round. And while the negotiations have dragged on, the world has continued to evolve, some would argue with accelerated pace. In the area of food and agriculture, developments have taken place since the beginning of this century that have transformed the landscape in which international policies for the sector, and in particular trade policies, must operate. Some of these developments pose challenges that were of lesser relevance when the Doha Round was launched and may require policy responses at the international level. The more prominent of these “new” challenges are briefly considered in this section.

## 2.1. A Changing Demand-Supply Balance on Global Food Markets

In the years following 2007, global food markets were hit by a succession of extreme price peaks. While markets for agricultural products always exhibit marked volatility, the magnitude and frequency of the price spikes experienced in 2007-08 and subsequent years were such that they drew significant political attention up to the highest levels of government.

There is a growing consensus that perhaps this was not just a passing episode of turbulence, but that it coincided with a shift in the longer-term trend of global markets for agricultural products. To be sure, more recently, prices on world markets for food and agricultural products have retreated noticeably from the extremely high peaks they had reached in the years following 2007. However, they are still well above price levels in the early 2000s and there are indications that we may have experienced an upward shift in trend. Market projections generated by different institutions vary in detail, but they are largely consistent in suggesting that the world appears to have embarked on a new and somewhat higher level of prices for agricultural commodities and food. For illustration, Figure 1 sets the world market price of wheat in real terms (as projected for the coming ten years by the OECD and the Food and Agriculture Organization—FAO) against its development since 1972. It also includes trend lines for the two periods before and since the start of the recent episode of large volatility (2007), suggesting that market conditions have changed: real prices

**Figure 1:** Price of Wheat in International Trade in Real Terms (i.e. Adjusted for Inflation)



have increased from the lows in the 1990s, although they are clearly lower than in the 1970s and are not expected to return to those extremely high levels. As projected, prices in real terms continue to exhibit a declining trend in the future but on a higher level. This change has occasionally been described as a shift from demand-constrained to supply-constrained markets in food and agriculture. Agricultural markets will continue to exhibit significant volatility (as discussed below), and there may well be episodes of declining and low prices. However, it appears that there is a high degree of probability that the price level on international markets for food and agricultural products in the years to come will be higher than prior to 2007.

Research continues on the relative contributions of various factors that may have caused this shift in market conditions. Accelerating income growth in many developing and emerging countries, coupled with ongoing urbanization, spurs the expansion of market demand for food. It also stimulates a change in diets towards a growing weight of livestock products, adding to demand for crops as animal feed. At the same time, the world's capacity to expand agricultural production may be less than in past decades. Prices of agricultural commodities have also been driven up by a rise in the price of oil and other energy sources since the beginning of the century, raising production costs and hence the price of agricultural and food products. In addition to the direct effect of energy prices, there is also an impact on demand for agricultural commodities resulting from the production of bioenergy (discussed below). The significant decline in the price of oil since 2014 has changed that picture and may, if it lasts, be followed by a downward adjustment of food prices. At present, one can only speculate on the extent to which changed conditions in the global energy economy will affect the future development of food prices.

As far as global food security is concerned, to be on the safe side it is probably advisable to be prepared for a situation in which international market prices for food remain not only rather volatile but also higher than pre-2007 levels. This has implications for the relative position of producers and consumers. In the past, low prices on international markets exerted adjustment pressure on farmers in rich countries and reduced incentives for agricultural development in less well-off economies. They also somewhat diminished the burden on poor food consumers. The traditional priority in agricultural negotiations under the GATT and the WTO—i.e. to work towards limiting protection and support provided to farmers—must be seen in this light. While the Doha Round is still facing a considerable amount of unfinished business of this nature, the higher price level to which markets may have shifted now means that equal weight should be given to considering approaches that can be used to protect food consumers against price peaks.

In that context, it is also relevant to consider the growing role of developing countries in agricultural trade. The share of non-least developed country (LDC) developing countries (defined on the basis of economic criteria) in world imports of agricultural products rose from 26% in 2000 to 41% in 2011, and is now close to 60% for cereals. In global agricultural exports, the share of non-LDC developing

countries increased from 34% to 45%. Even for meat and fish products, where non-LDC developing countries accounted for only 16% of world imports in 2000, this share reached 34% in 2011. These trends mean that developing country markets can no longer be considered peripheral, as they represent a significant share of international trade and an overwhelming contribution to growth.

## 2.2. Bioenergy

A sizeable percentage of crop production in some parts of the world is currently used as feedstock for the production of biofuels. About 65% of vegetable oil output in the European Union, 50% of sugarcane in Brazil, and 40% of maize in the United States are used for that purpose. Use of crops for biofuel production is predicted to grow further. Market projections issued by the OECD-FAO (2014) expect that in 2023 no less than 12% of global coarse grain production and 28% of global sugarcane production may be used to produce ethanol, and that 14% of global vegetable oil output will be converted into biodiesel. In addition, other crops are used as feedstocks while alternative forms of renewable energy (e.g. biogas) are also produced from agricultural products. The mass use of agricultural commodities, including those that could be used as food, to generate energy is a relatively new phenomenon—virtually non-existent when this century began. The only exception is Brazil where conversion of sugarcane into ethanol began in the 1970s.

To a very large extent, the production of bioenergy depends heavily on government support provided in various forms, including subsidies, tax credits, and quantitative mandates. Brazil is, again, an exception as ethanol production from Brazilian sugarcane is commercially viable unless the price of sugar is very high or the price of crude oil is low. There is little doubt that the large-scale introduction of bio-based fuels into energy markets in North America and Europe (and some other countries) would not have taken place in the absence of government support, estimated to be in the order of US\$20 billion per year globally. At the low crude oil prices that prevail in 2015, even less of the world's biofuel production is commercially viable.

The rapid expansion in the use of agricultural commodities as feedstock for the production of bioenergy has been blamed by several authors as one of the major contributing factors behind the peaks in food prices experienced in recent years (see, for example, de Gorter, Drabik and Just (2015) and the literature referenced there). The jury is still out on the magnitude of the impact. However, there can be little doubt that the international market prices of agricultural commodities that are primarily used as feedstock would be lower in the absence of biofuels support, although estimates of the precise extent vary. The limited response of biofuel production to changes in the price of agricultural feedstocks, in particular where biofuel use is determined by quantitative mandates, also tends to add to the large price volatility on global markets of the agricultural commodities concerned. The closer correlation between prices for fossil energy and food that has been observed in recent years is a novel phenomenon that poses new challenges for global food security—challenges that could become more acute if energy prices were to rise again.

### 2.3. Market Volatility

Markets for agricultural commodities have always exhibited volatility. On international markets, this phenomenon is even more pronounced. Global markets for many agricultural products tend to be “thin,” with international trade sometimes amounting to no more than single-digit percentages of global output. The “thinness” of global markets for agricultural and food products is further aggravated by a tendency on the part of governments to insulate domestic markets from international price swings. Potentially marked changes in global output from year to year must therefore, to the extent that it is not compensated by stock changes, be buffered by a world market that is small relative to the overall volume of global output—with the consequence that price swings can become rather large.

While a significant degree of variability has thus always characterized markets for food and agricultural products, experience shows that once in a while there is a bout of extreme volatility on international markets. Typically, this extreme volatility is asymmetric in nature, with upward price spikes much larger than downward price declines. This tendency is closely related to the storability of many agricultural commodities. When prices fall, agents tend to put commodities into storage. But when prices rise, a point can be reached where stocks are virtually depleted and no additional supplies can come on the market. In recent decades, the world has seen one such episode of extreme upward price explosions in the 1970s and a second in the period since 2007.

The most recent episode of extreme volatility differs in part from the experience in the early 1970s in the sense that it has been characterized by a number of successive price spikes following each other at short intervals. A number of factors have been identified that may have contributed to each individual event of repeated volatility in recent years. These include: extreme weather events; developments in markets for other commodities (especially energy); new forms of financial investment in commodity exchanges; currency developments; rapid expansion of feedstock use for biofuels; and *ad hoc* export restrictions. Some of these factors have resulted in low stock-to-use ratios for several key commodities, which reduced the buffering capacity of markets and hence amplified price explosions.

Whether all or most of these factors will continue to impact markets for food and agricultural products in the years to come is difficult to predict. It does, though, appear that extreme weather events have become more likely as a consequence of climate change. That factor alone may mean that markets will continue to exhibit a marked degree of volatility in the future—larger than the “traditional” volatility that has always plagued agricultural markets. Recent price peaks have served to attract new attention to this phenomenon of food market volatility and to demonstrate the importance of developing appropriate and effective responses to a situation that can have dire social consequences.

### 2.4. Climate Change

The challenges posed by climate change are not new but the main implications for agriculture have become considerably clearer in the last ten years or so. Compared to other sectors, agriculture is unusual in that it can contribute to both increasing and decreasing the concentration of atmospheric greenhouse gases (GHGs). Agricultural production is a major source of GHG emissions, directly accounting for an estimated 10-12% of the global total. If the clearance of uncultivated land for agriculture is taken into account, the contribution is substantially higher. Moreover, the food and agricultural industry is a major user of energy in the production of inputs, the processing of commodities, and the use of transportation, all of which also generate significant GHG emissions. On the other hand, agriculture (and forestry) can also recycle or remove carbon from the atmosphere for significant periods of time through sequestration. It can also produce commodities that potentially help to reduce overall GHG emissions by substituting for fossil fuels. For all of these reasons, adjustments in agronomic practices and in agriculture’s product mix can make a major contribution to mitigating climate change, and global agriculture is likely to be called upon to do so increasingly in the future.

At the same time, agriculture and food production are particularly susceptible to the impact of climate change due to their dependence on natural conditions. How agricultural production will precisely be affected by climate change is still a matter of debate, and will probably remain so for quite some time given the complexities of forecasting climate change and understanding the impact of climatic conditions on agricultural production. However, there appears to be growing consensus on two major implications. First, extreme weather events such as droughts, floods and storms are projected to become more frequent. As a result, year-to-year variability of agricultural output at any particular location (though not necessarily at the global level) is expected to increase. Second, the impact of climate change on agricultural production is likely to exhibit marked spatial differentiation. While growing conditions in temperate zones are expected to improve (higher temperatures, longer growing seasons), output potential in tropical territories is likely to be negatively affected (more heat, more drought, shorter growing seasons), although there may also be marked localized variations in impact. As the majority of developing countries are located where agricultural output is projected to suffer most from climate change, the trend for developing countries in aggregate to become increasingly dependent on food imports (in particular cereal) from richer countries is likely to be further enhanced. In addition to overall changes in the volume of agricultural output, production patterns in terms of product composition are also likely to change. While there may be a political temptation in many countries to resist such modifications in agricultural production in response to climate change, it should be clear that they will reflect evolving patterns of comparative advantage and that attempts at resisting them could come at potentially high costs.

The challenges posed by climate change for the trading system are at least fourfold. First, trade is a powerful means of bridging spatial differences, both in the short-run (resulting from extreme weather events) and in the longer-run (caused by differential impacts on output potential). The more freely trade can flow, the more it can fulfil this balancing function. Second, as governments seek to support both the mitigation potential and the adaptation capacity of their domestic farming industries, there may be a tendency to resort to policies that have the potential of interfering with trade. Third, the apparent need for policy responses to the implications of climate change (and the complexity of the matter) can easily be used as pretexts for protectionist measures. Fourth, it is obvious that international agreements are urgently needed to address these global challenges—yet it has also become increasingly clear how difficult they may be to reach.

## 2.5. Environmental Issues

The relationship between agriculture and the environment poses challenges that are somewhat similar to those resulting from climate change. Agriculture can both cause environmental damage and contribute to improving environmental conditions. In both regards, mounting attention has been paid in recent years to this relationship.

Growing intensification of agricultural production in large parts of the world has amplified pressure on the environment, biodiversity, and other natural resources, including water. In some countries and regions, farmers, governments and non-governmental organizations (NGOs) have progressively expressed concerns regarding the resulting damage, and a number of negative impacts have begun to be redressed. At the same time, it is increasingly recognized, in particular in the more affluent parts of the world, that agriculture has genuinely contributed to shaping valued features of the countryside and that farming activities can, if properly practiced, help preserve the environment. Environmental policies in agriculture have therefore gained traction.

Some of the policy measures used to address the environmental implications of agricultural production have the potential to interfere with international trade. For example, where governments support certain agricultural practices that are assumed to be beneficial for biodiversity, the disposal of the agricultural output produced may be deemed to cause difficulties for producers in third countries. Also, when a government imposes more demanding animal welfare standards on domestic producers, there is a temptation to ensure that imports originating from countries with less demanding standards do not outcompete the “well-behaved” domestic farmers. For such reasons, environmental issues in agriculture have the potential to cause growing tensions in the international trading system. It will be important to examine solutions that allow for a fair balance between environmental sustainability and non-discriminatory trade rules.

## 2.6. Experiences in Implementing the Agreement on Agriculture

Although the Agreement on Agriculture concluded during the Uruguay Round (1986-94) has fundamentally changed the rules of the game, quantified constraints are not very demanding and have left considerable room for continuing “old” policies. Squeezing water out of these quantitative constraints under the AoA, and making further headway towards allowing market forces rather than government interference to determine trade flows in agriculture, is a major aim of the Doha Round.

Experience in implementing the AoA has also pointed at a number of issues and loopholes that require attention. Some have to do with the definition of rules in the agreement and others with the way governments have chosen to deal with them.

An example of the former category is the AoA definition of market price support, based on fixed external reference prices, some of which are by now way out of line with actual market conditions. In the same context, the definition of the “eligible quantity” of production has left too much room for interpretation. Another example is the definition of domestic support measures exempt from reduction commitments (Green Box subsidies). Subsidies notified under the Green Box have increased significantly since the AoA was concluded, both in absolute terms and as a percentage of overall domestic support. Movement in the direction of less trade distorting policies, as signalled by the growing share of support placed in the Green Box, is a desirable trend—as long as support overall does not expand. However, the increasing weight of the Green Box makes it increasingly important to look at concerns that have been raised regarding both the general requirement for such measures (“that they have no, or at most minimal, trade distorting effects or effects on production”) and the specific criteria for individual categories of Green Box policies. In addition, new measures that were not yet known when the Green Box was created have been introduced and notified under the Green Box. One concrete example of the relevance and political sensitivity of these issues surrounding the interpretation and implementation of AoA rules is the debate on public stockholding programmes for food security purposes, which played an important role at the WTO Bali Ministerial and continues to be a prominent issue in the ongoing negotiations.

When it comes to government dealings with AoA rules, a number of deficiencies in the notification process stand out. To be sure, notification requirements introduced under the AoA have greatly enhanced the transparency of agricultural policies. However, several *desiderata* remain. The value of notifications is seriously compromised by frequently late submissions. And a pressing issue in the Green Box notification process is the fact that countries are not required to justify the allocation of reported measures to the twelve individual categories of Green Box policies based on the specific details of the respective measures.

## 2.7. Regional Trade Agreements

The multiplication of preferential trade regimes has become a defining feature of international trade. From 123 regional trade agreements (RTAs) notified to the WTO in 1995, the figure had risen to 612 by April 2015 (counting goods, services and accessions separately) of which 406 were in force. While until the early 2000s RTAs tended to be geographically regional, this is no longer the case as agreements between partners on different continents have become more frequent.

A significant share of total world trade is now conducted between members of preferential arrangements. In agriculture and food the share is approaching 40%—larger than in manufactures. Tariff concessions are often significant under RTAs. In a study of a sample of 74 RTAs, Bureau and Jean (2013) found that when tariff concessions are fully phased in, the preferential margin is close to ten percentage points. Over the agreements considered in the study, and other things being equal, RTAs were estimated to increase agricultural and food exports between signatories by 32 to 48%. On average, trade impacts are larger for agreements between developing countries and, generally speaking, for agreements granting higher preferential margins, in particular when the partner's initial market share is low. Such impacts are sizeable enough to exert a profound influence on trade patterns.

In addition to RTAs, there have been some significant changes in non-reciprocal preferential regimes, with potentially significant consequences for WTO negotiations—especially in relation to Special and Differential Treatment. In some cases, non-reciprocal concessions have been amended so as to make them compatible with WTO rules. Developed countries have also reformed their Generalized System of Preferences (GSP) regimes in different ways. Countries that are signatories to an RTA have generally been removed from the list of GSP beneficiaries. Others have either been “graduated” or excluded from preferences because they were considered to have reached a level of development that no longer justified tariff concessions or because they had become aggressive competitors to local producers.

## 2.8. Changes in Policy Regimes in Major Countries

In agriculture, disciplines and commitments applicable in the WTO have not been modified since the completion of the Uruguay Round. Actual policies, however, have evolved in many countries, sometimes significantly.

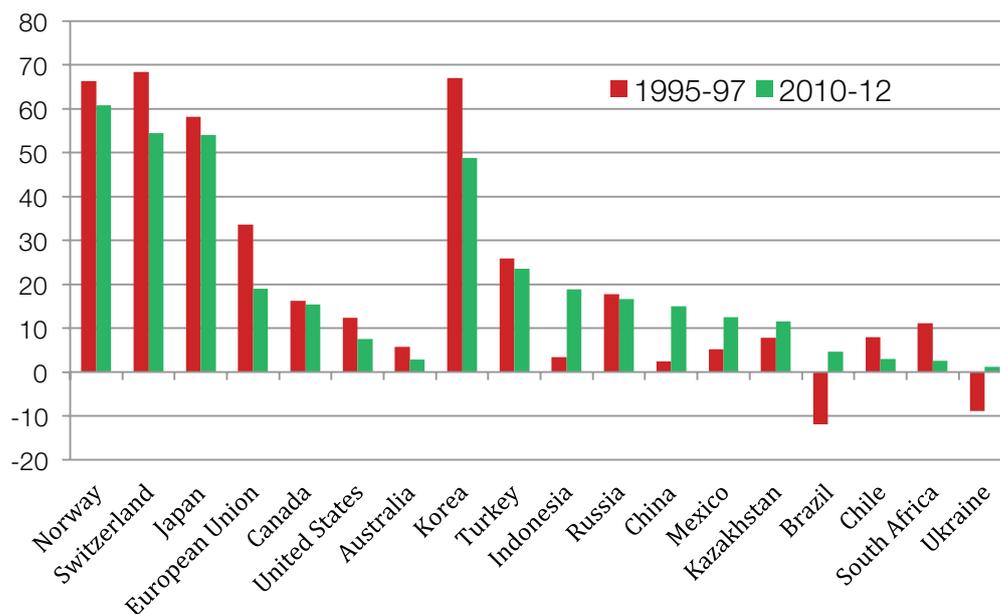
As far as border protection is concerned, bound tariffs have not changed substantially since the end of the AoA implementation period (end-2000 for developed countries, end-2004 for developing countries) except for new WTO members. In contrast, applied protection has steadily declined. Globally, applied most-favoured-nation (MFN) duties for agricultural products were cut from an average 24.6% in 2001 to 18.7% in 2010, and applied duties (including preferential tariffs) from 15.8% to 13.8% (Bureau and Jean 2013). The cut in MFN applied duties was especially steep for countries classified as developing in the WTO, from an average 31.1% to 23.2%. This is barely more than a third of their average bound duties (61.3%) and applied tariffs are yet lower (19.8% in 2010). This means that any realistic cut in developing country bound tariffs is unlikely to alter significantly the applied tariff protection.<sup>2</sup>

Another consequence is that a considerable increase in agricultural protection is technically possible without infringing current WTO rules: MFN applied duties can be raised up to the level of bound duties and contingent protection can be used in a variety of ways. While the average applied tariff worldwide in agriculture stands at around 14%, if all WTO members were to raise their applied tariffs to the maximum (bound tariffs except where an RTA applies), average protection would double to 28%.

In parallel with declining border protection, measured gaps between domestic and international market prices have decreased in many countries since the mid-1990s. In most developed countries, domestic support as reflected in notifications to the WTO has also declined, at least relative to the value of agricultural production. More significantly, in a number of developed countries the structure of support has undergone marked change, with a growing share of support notified under the Green Box and a declining share of support outside of the Green Box. The same cannot be said for developing and emerging economies, where overall support levels in certain countries have grown, with no significant shift in the structure of support towards less trade distorting forms such as those covered under the Green Box. Concurrently, use of export subsidies by developed countries has declined significantly. Export subsidies granted by the EU, which accounted for around 90% of global expenditure on formal agricultural export subsidies in the early 2000s, have virtually disappeared. Over the recent period marked by high agricultural prices, it could be argued that export restrictions have had a greater influence on market conditions than export subsidies provided by entities such as the EU.

<sup>2</sup> India epitomizes this situation with an average MFN applied rate for agricultural products equivalent to less than a third of the bound rate (39.4% vs. 136.1%). But the issue is similar in nature for Mercosur where it equally (and more importantly) concerns non-agricultural products.

**Figure 2: Producer Support Estimates 1995-97 and 2010-12**  
(Percent of Gross Farm Receipts)



Source: OECD 2013

Domestic support notified to the WTO is based on legal concepts and does not necessarily reflect developments in actual support levels as defined in economic terms. This is especially the case for market price support, where the WTO definition uses administered domestic prices and fixed external reference prices rather than actual domestic and international market prices. Yet a look at actual support rates as estimated by the OECD, which expresses the joint effect of border protection and domestic support, confirms the overall trend of a decline in support rates among major developed countries while they have tended to rise in major emerging countries (Figure 2). Depending on future policy trends and the outcome of WTO negotiations, it is conceivable that the centre of gravity in agricultural policy support may increasingly shift to developing and emerging economies.<sup>3</sup>

<sup>3</sup> Brink (2011), for example, found that application of the parameters suggested in the Doha draft Modalities of December 2008 could mean that allowances (after reduction commitments) for overall trade distorting support, including in particular de minimis allowances, might be such that all developing countries taken together could provide 73% of agricultural support in the world

# 3. Policy Options

Based on the developments outlined above, this section considers trade policy options for the future in two areas: adapting the WTO Agreement on Agriculture and the SPS Agreement; and more general WTO rules of particular importance for food and agriculture, specifically with regards climate change and the environment. It then puts forward policy options targeted at international cooperation to improve food security and fostering agricultural productivity.

## 3.1. Adapting the WTO Agreement on Agriculture and the SPS Agreement

The WTO provisions with the most direct bearing on food and agriculture are those established by the Agreement on Agriculture and the SPS Agreement. These provisions—in particular those of the AoA—have been in the spotlight in the course of the Doha negotiations and adapting any of them is a politically sensitive matter.

### 3.1.1. Traditional items on the negotiating table of the Doha Round

The challenging developments in the world's agriculture and food economy since the beginning of the century have made it vital that agricultural trade effectively perform its crucial function of building bridges between deficit and surplus countries, and that international markets for food and agricultural products operate efficiently so as to ensure that the world's increasingly scarce resources are used in an optimal way to provide adequate food supplies to a growing and more demanding population. Further progress is needed on all three existing pillars of the AoA—i.e. market access, domestic support and export subsidies.

As far as market access is concerned, a further reduction in tariffs will facilitate the integration of domestic markets with international trade and the transmission of price signals. It will thereby contribute to dampening the volatility of international markets that has caused so much concern in recent years. Given that in many countries there is a significant gap between bound and applied tariffs for agricultural products, cuts in tariff bindings will also improve the transparency and reliability of trading conditions. There is general recognition of the need to provide scope for protecting fragile domestic markets against sudden upsurges in imports, although the specific parameters for safeguards remain controversial.

Tighter disciplines for domestic support will help to guard against unfair competition and inefficient use of productive resources. At the same time, they are needed to ensure that subsidies are not used to negate the intended benefits of

tariff cuts. Agreement on further reductions of both tariffs and domestic support should be facilitated by the changes in market conditions that have occurred in the recent past: with higher prices expected to prevail on international markets for food and agricultural products, the political objections to reducing high tariffs and subsidies should be less pronounced than in the past.

Subsidies distorting export competition have always drawn harsh criticism. They constitute a particularly unfair form of competition, setting governments against each other instead of enabling the most cost-effective producers to prosper. The significant decline in export subsidies over the last decade should make it relatively easy to push for an end to this harmful practice. There is an opportunity to approximate rules for agriculture with manufacturing, where export subsidies have been prohibited for decades. Moreover, many governments have come to understand that state-trading enterprises can create more problems than they solve.

The Doha negotiations on all three of these pillars have already made much progress, as evidenced by the substantial amount of agreed matter embodied in the draft Modalities of December 2008. It is worth a concerted effort on the part of all WTO members to bring these negotiations to a successful conclusion in the near future.

Coming to terms with the items already on the negotiating table is even more important as the challenges that have arisen since the Doha Round began also require attention. Policy options that can be considered in that context are discussed in the remainder of this paper.

### 3.1.2. Rules for export taxes and restrictions

During the long period when global markets in food and agriculture were demand-constrained, the need to protect food consumers against policy-driven market fluctuations was not considered a priority issue. In trade negotiations, attention focused on disciplining import barriers and subsidies. Export barriers did figure in the GATT/WTO, but disciplines were relatively weak and not necessarily taken seriously in the practice of trade policy-making. As the world appears to have embarked on a higher level of food prices on international markets, much more attention is now justifiably being paid to export barriers. When markets exhibited increased volatility in recent years, a number of major food exporters implemented various forms of export taxes, restrictions and bans. Most observers agree that these export barriers, often introduced rashly and in an *ad hoc* manner, contributed significantly to driving international

market prices to extreme peaks. In response, calls for the introduction of more stringent disciplines on export barriers have been voiced in various fora, including the WTO.

Much can be said for the argument that international trade rules should be symmetric. Discipline should be imposed not only on importing countries and exporters who subsidize (so as to protect competing producers in other parts of the world against depressed prices and shrinking markets), but it should also apply to exporting countries that discriminate in favour of domestic users by withholding supplies from those in the rest of the world. From this perspective, it is encouraging that the Doha negotiations have already looked at rules regarding prohibitions and restrictions on food exports. Establishing symmetry between rules for importing and exporting countries should help move the negotiations forward. Disciplines on export restrictions should also be of interest to exporting countries in view of the fact that an agreement on this issue would provide assurances to importers who may otherwise be tempted to self-insure against potential trade disruptions through increased domestic protection and subsidies.

More up-to-date information on export restrictions would benefit the smooth functioning of markets for food and agricultural products. This improved transparency will be particularly helpful if it is combined with better information on stock levels, such as that which may emerge through the Agricultural Market Information System (AMIS) in which the main producing, importing and exporting countries cooperate with assistance from a secretariat formed by the FAO and other international organizations. An option would be to require notification of any new export constraints, including changes in export taxes, to the Rapid Response Forum established under AMIS.

Another option would be to establish a procedure that could serve to identify whether an exporting country is actually in a situation where it has reason to adopt an export restriction in order “to prevent or relieve critical shortages of foodstuffs” as stipulated in GATT Article XI. As this option would not necessarily require modification to either the GATT or the AoA it could also be considered independently of an overall conclusion of the Doha negotiations.

A step requiring the adoption of new legal language would be to move in the direction of the commitment undertaken by the G20 Agriculture Ministerial in Paris in 2011 — i.e. to exclude from any restrictions shipments destined to serve as food aid to countries in an emergency. In spite of the G20 commitment to bring this option to the WTO the mandate has stalled. If multilateral consensus cannot be found to adopt a provision along these lines, it could become the basis for a plurilateral agreement of the “willing” open to future accession by other countries.

A more demanding option would be to include export taxes explicitly in any new rules on barriers to food exports. Although it can be argued that export taxes are, under certain conditions, covered by GATT and AoA provisions on export restrictions, specific rules could help to ensure that taxes are not used to circumvent disciplines on restrictions. A possibility to be considered would be to bind rates of

export taxes on food (and possibly other products) in much the same way as tariffs are bound. This option could also include the introduction of export tax rate quotas that would mirror the tariff rate quotas frequently used in agriculture. Quotas could be based on past exports (either a fixed average using a base period or, preferably, a moving average). The in-quota tax could be the average export tax applied in recent years, at no more than an agreed maximum rate. To avoid lengthy negotiations, the above-quota rate of export tax could be constrained to twice the in-quota rate.

An approach like this, if combined with effective disciplines on quantitative export restrictions, could greatly enhance the transparency and predictability of international food trade in times of scarcity.

### 3.1.3. Provisions for support to bioenergy

As in the case of barriers to food exports, government support for the production and use of biofuels was not considered an important issue for international trade relations as long as international market prices for agricultural products were depressed. After all, when a number of countries began to channel agricultural products into the production of energy, this was considered to ease competitive pressure on farmers in the rest of the world. However, when global food prices began to rise, thereby placing a growing burden on consumers, support to biofuels appeared in a new light. Not surprisingly, it turned out that international trade rules, developed at a time when biofuels were virtually non-existent, were not designed to impose effective disciplines on the harm that biofuel support could inflict on food consumers. Hence there are good reasons to consider options for dealing with biofuel support in the WTO.

A first and rather fundamental option would be to create more transparency regarding the types and levels of government support to biofuels. In the WTO, some subsidies to biofuels are notified either under the Agreement on Subsidies and Countervailing Measures (ASCM) or under the AoA, or in both contexts. However, notifications are far from comprehensive and where they occur they do not provide sufficient detail to allow an analysis of their trade implications. Transparency would be greatly improved if clear rules were developed as to how and where support to biofuels has to be notified and which forms of support are to be covered. For purposes of transparency it should not matter too much whether notifications come under the heading of the ASCM or the AoA.

Considerably more demanding would be an option that aims at establishing effective and comprehensive disciplines on the magnitude and use of support to biofuels. Without doubt, this would require some innovation in legal approaches, for example regarding the definition of what constitutes an agricultural product covered by the AoA and also the treatment of measures such as use mandates as a form of subsidy. Given the close relationship between biofuels and the food and agriculture sector, it might make sense to consider the option of adapting existing rules such that biofuel support falls under the realm of the AoA.

Introducing disciplines for support to biofuels under the AoA would be in line with the suggestion to establish constraints on product-specific support as foreseen in the 2008 draft Modalities.

However, if the intention were to place effective constraints on the extent to which biofuels support can distort markets, with a particular view on the implications for food consumers, then a wholly new approach would have to be developed. Including support to biofuels under AoA commitments on trade distorting domestic support would not only require the definition of new base commitments, it would also not be aligned with the nature of existing AoA commitments, as in many cases support to biofuels benefits not only domestic farmers but also producers in the rest of the world. One option that could be considered would be to introduce a fully new category of commitments, specifically covering biofuel support, aimed at constraints on the burden placed on food consumers rather than the benefits to farmers.

#### 3.1.4. Green Box rules

The core of the Green Box, and the justification for exempting respective policies from reduction commitments, is “the fundamental requirement that they have no, or at most minimal, trade distorting effects or effects on production” and the criterion that “the support in question should not have the effect of providing price support to producers.” An option is to reconsider the relationship between the fundamental requirement and the policy-specific criteria to be met by the individual categories of measures included in the Green Box, with a view to shifting the burden of effective definition towards sharpened policy-specific criteria.

The draft Modalities of 2008 contain a number of suggested refinements to policy-specific criteria, typically derived from experiences in implementing the Green Box since the Uruguay Round. One of the suggested changes that would appear to be quite important is that the basis of certain payments should be a “fixed and unchanging historical base period.” An option that could be considered would be to seek early agreement on such modifications, most of which would do no more than clarify the criteria for future policy pursuit without requiring changes in existing programmes.

Other elements suggested in the draft Modalities would provide somewhat broader scope for measures that are particularly relevant for certain groups of countries. An example is the proposed implementation of public stockholding for food security purposes in developing countries such that the acquisition of stocks provides support to low-income or resource-poor farmers. The holding of food stocks, if targeted at emergency situations and poor consumers, is certainly an important option for food security policies in developing countries, which is the reason why this element was included in the Green Box. Whether it is helpful for the rational pursuit of an overall set of well-designed policies to establish a direct link between this consumer-oriented policy and support for certain groups of producers is a different matter. The Decision on public stockholding programmes for food security purposes

taken at the WTO Bali Ministerial requires the design of appropriate rules for these policies.

At a different level, it would appear sensible to improve transparency, and help monitor policy development, by requiring that notifications provide more detail on the implementation of measures to be covered by the Green Box so that their potential trade impact can be more effectively assessed and their Green Box status can be challenged if necessary.

A more fundamental question is whether the Green Box criteria should be amended such that governments are more effectively guided in the direction of policies that can be genuinely considered to provide public goods and strengthen sustainable development. Views differ on whether incentives for “good policies” are well placed in rules for international trade, or whether the sole purpose of the multilateral trade regime is to minimize interference with the interests of other countries. It would appear highly desirable to clarify this fundamental issue and hence whether the primary aim of updating the Green Box rules should remain to clarify and sharpen the policy-specific criteria such that trade impacts are avoided as much as possible, or whether a broader approach should be developed that supports policies which aim to encourage sustainable development, environmental progress and responses to climate change. It will remain a challenge to find an acceptable balance between legitimate interests in pursuing policies that provide desirable public goods on the one hand, and the avoidance of trade impacts on the other.

Finally, it may actually be time to consider one significant departure from a fundamental element of the underlying philosophy behind the Green Box. The Green Box was created to leave space for certain benign policies, without quantitative constraints. The economic logic was that there are policies whose trade impact is so small that there is no need to be concerned about potential negative implications for trading partners. Two reasons may justify a reconsideration of that philosophy. First, research has shown that even the most apparently “decoupled” policies still tend to have some trade impact. Second, given the large sums that are spent on Green Box policies in some parts of the world, even a small trade impact per dollar may no longer be small if multiplied by a large number of dollars. With these two considerations in mind, the question is increasingly being asked as to whether constraints on the overall amount of support spent under the Green Box should be introduced in order to guard against excessive use of the policy space provided by the Green Box.

In considering that question, it would appear sensible to make a distinction between two rather different broad categories of policies covered by the Green Box. On the one hand, there are measures aimed at providing public goods, such as environmental improvement, mitigation of climate change, infrastructure upgrade or training and extension services. On the other hand, there are measures primarily aimed at providing income support to farmers. The rationale for including the provision of public goods in the Green Box, and hence for not constraining expenditure on such measures, is that governments need to have the opportunity

to do their job. Even though it cannot be completely excluded that some limited production and trade impacts may result from these policies, as discussed above, there would appear to be good reason to continue to exempt such measures from international expenditure discipline as long as they respect the relevant policy-specific criteria.

Farm income support, however, is a different matter. It may have a role to play as an ingredient of policy reform, where the impacts on income of cuts in other, more market and trade distorting measures are compensated through more decoupled forms of support. Ideally, such compensation should be time-limited, providing farmers with breathing space to adjust to a changed policy environment. It is hard to argue that specific farm income support (as opposed to general social protection regimes) should be provided on a permanent basis. Hence it may be useful to consider whether, at some point, a constraint should be introduced on that type of Green Box support.

It would not appear sensible to make any such constraint subject to demanding reduction commitments because that would eliminate the whole rationale underlying the Green Box. Indeed, it may be sufficient to make sure that spending on the programmes concerned cannot increase without limit. Some form of constraint on Green Box subsidies targeting farm income support may both allay concerns about further “box shifting” and improve the balance between countries that have either good or limited access to fiscal revenues.

### 3.1.5. Transparency provisions

The need to improve transparency in the area of agricultural trade policy has been widely recognized. The opportunity to make some constructive changes has led to the negotiation of revised provisions in the AoA as part of the Doha Round. As the eventual fate of the round is still in doubt, there is a case for taking up some of these issues as part of an early agreement.

The most immediate improvement to transparency would follow from the adoption of the proposals in Annex M of the Doha draft Modalities. Although negotiated as part of a package, there is no reason why it should not become a stand-alone agreement. The proposal does not involve changes in national regulations and would not seem to favour any country over others. It would merely replace the somewhat vague provisions in the current AoA with requirements that are more detailed. As foreseen in the draft Modalities, resources could be made available for developing countries that face difficulties in preparing notifications, with a potential side-benefit to those countries of having to describe policy measures in an agreed format.

A similar option that would require little in the way of formal negotiations would be to expand somewhat the amount of information included in the Trade Policy Reviews. This would appear preferable to initiating a separate review for agricultural policy as suggested by the G20 in 2007.

More radical would be the introduction of new incentives

for compliance with monitoring requirements and respect of deadlines. These could take the form of assumptions of ineligibility for benefits (such as excluding Green Box and Development Programmes from the aggregate measure of support) until eligibility has been affirmed. This would require more than a simple monitoring decision and it would change the legal interpretation of the obligations to notify. In effect, it would reverse the current assumption of “compliant unless successfully challenged.” It would also introduce the potentially useful concept that a specific “benefit” claimed by a member has to be backed up with evidence of eligibility.

### 3.1.6. Sanitary and phytosanitary matters

As tariffs applied in agricultural trade have declined in recent decades (see Section 2), non-tariff measures (NTMs) have gained in importance. In trade in agricultural and food products, sanitary and phytosanitary measures are the most prominent NTM. Their use is regulated through the SPS Agreement. The Doha mandate does not foresee negotiations to modify the SPS Agreement but requests work on implementation issues. There are indeed a number of such issues, including some that go beyond those considered explicitly in the Doha context, which could, if dealt with successfully, improve the functioning of the agreement.

Among these issues is a more effective notification system that would improve transparency through the provision of more detailed information on the measures notified. Also, when an import approval request is refused on SPS grounds, more timely and substantive responses to the request would help to find ways of overcoming difficulties.

One of the key aims of the SPS Agreement is greater harmonization of health and safety standards. A major improvement in this regard would be more ample use of international standards in national SPS regimes, as advocated by the SPS Agreement. So far, use of international standards is fairly limited, with substantial variations across countries, products and regulatory objectives. Developed countries have tended to use international standards less than developing countries. More comprehensive and accurate information on the extent to which individual countries have adopted international standards (and publication of that information) might pave the way towards greater use of international standards. This objective might also be served if countries, in their notifications of SPS measures to the WTO, would have to explain conclusively why they do not apply international standards when such is the case. More and better information on the relationship between standards applied by individual countries and existing international standards would facilitate the efforts of exporting countries, in particular developing countries, to meet SPS standards and thus gain access to markets in importing countries. More analysis of the extent to which the application of international standards affects trade flows would also be useful. Where international standards do not exist, as is the case for many products and SPS issues, the development of standards by respective international organizations is highly desirable. Because of capacity constraints, most developing

countries face particular difficulties in establishing effective SPS regimes. Assistance to build the capacity to implement international SPS standards, guidelines and recommendations is urgently needed—not only for trade-related issues, but also to improve the quality of domestically produced food in developing countries and to protect their productive capacity from pests and diseases. It would be desirable to support and strengthen the Standards and Trade Development Facility—a partnership that includes the FAO, the World Organisation for Animal Health, the World Bank, the World Health Organization and the WTO.

It would also be useful to clarify the relationship between private standards and public standards. In the WTO, the legal status of private standards remains vague and should be better defined. For national governments, there are issues regarding the priority to be given to public versus private standards, depending on the products and regulatory objectives involved.

### 3.2. Preparing WTO Rules for the Future

All general provisions of the WTO also apply to agricultural and food products (except where the AoA overrides them). This dichotomy is likely to continue for some time, as it will take a while to progress from the GATT's relatively loose treatment of agriculture to a full inclusion of agricultural and food products into the provisions for all other goods. The particular importance of agricultural products for livelihoods in developing countries, and of food as a basic necessity for all, mean that there will probably always be some specific provisions for food and agriculture in the WTO framework—even if eventually a separate AoA may no longer be needed.

At the same time, some of the general rules that apply with equal force to agriculture are of particular significance to the sector and may require specific attention when preparing for the new challenges. In that context, this paper will consider one set of issues: matters relating to climate change and the environment.<sup>4</sup>

#### 3.2.1. The WTO and policies addressing climate change and the environment

Growing concerns about climate change and the environment have led many governments to design policies that lead farmers, and sometimes also consumers, in the direction of engaging in practices that are more environmentally friendly while also developing approaches that make agricultural production more resilient to the impacts of climate change. Where subsidies are involved, they are governed by the respective rules in the AoA, in particular those in the Green Box (as discussed above). Where these policies come in the form of domestic taxes and regulations, they are, as such, unlikely to cause tensions in the trading system since they do not impose a burden on foreign producers. However, it is probable that there will be

a growing tendency to underpin restrictive domestic policies (e.g. taxes, regulations) through measures that operate at the border. As far as climate-related policies are concerned, the inclination to complement restrictive domestic measures by trade-related instruments is primarily motivated by fears of “carbon leakage” (i.e. production shifts to countries where GHG emission standards are less demanding). In policies addressing the environment or animal welfare, equivalent concerns occur. Where policies operating at the border come into play, general WTO rules are relevant.

Political pressure to complement restrictive domestic measures by border policies tend to be particularly pronounced in the agricultural sector, above all in developed countries. Through a long history of protective agricultural policies, farmers are often used to being supported. Once restrictive measures are imposed on them, such as taxes or requirements to engage in practices that are friendly to the environment or animals, they complain about the negative impact on their international competitiveness. Pointing to the “carbon leakage” phenomenon is an argument readily used to argue for keeping non-complying products out of the domestic market—and the argument carries some weight as it is fundamentally to the point.

Two categories of policy measures applied at the border are particularly relevant in this context. Border tax adjustments can be considered to offset a cost disadvantage of domestic production resulting from measures relating to climate change or the environment. Alternatively, standards imposed on domestic producers for such purposes could be extended to imported products. In both cases, current WTO rules (and their interpretation in dispute cases) leave sufficient ambiguity to make it difficult to design appropriate policy measures that are safe from legal challenge. Border tax adjustments are consistent with WTO rules. But their implementation can cause problems and could be challenged on the basis of a violation of the non-discrimination principle of the GATT—both relative to domestic producers and regarding equal treatment of foreign suppliers. In both instances, the legal issue of “like” products can cause headaches. When it comes to climate and environmental policies, the object of relevance is typically not the characteristic of the traded product but the nature of emissions during its production. This raises the issue of whether differential treatment based on processes and production methods (PPMs) is permitted, and, if so, under what conditions. Difficult empirical matters may also be involved in estimating cost differences. Moreover, where the domestic measure is a regulation rather than a tax, it is not necessarily clear whether provisions for border tax adjustment are applicable at all.

The application of domestic standards related to

<sup>4</sup> The E15 Expert Group on Measures to Address Climate Change and the Trade System has discussed these issues in detail and their policy options paper can be referred to. This paper offers a few brief observations from the specific perspective of food and agriculture.

environmental protection and climate change raises similar issues. It also brings into play the exceptions of GATT Article XX, which may allow the application of otherwise not permissible border measures under certain conditions. The article has been cited in a number of disputes on environmental policies. This GATT provision could potentially also underpin the introduction of border tax adjustments. Yet another issue results if cap-and-trade regimes were to be applied broadly in agriculture. Is the free allocation of emission permits to domestic producers a subsidy? Does it depend on the generosity of the allocation?

In short, the growing importance attributed to agricultural policies related to climate change and environmental protection makes it desirable to clarify the conditions under which the WTO permits the use of border measures designed to prevent trade from undermining the effectiveness (and political acceptability) of domestic policies in this domain—i.e. to avoid “carbon leakage” and equivalent impacts.

### 3.3. International Cooperation to Improve Food Security

Trade is a powerful engine to improve food security. In a direct way, it serves to supply deficit countries with their food requirements. As developing countries on aggregate exhibit growing demand for food imports, they will have a strong interest in making sure that food trade can flow freely to them. Trade can also improve food security in an indirect way by promoting economic growth, job creation and rising incomes to reduce poverty. However, in addition to fostering a well functioning and fair trade regime, the international community can engage in other activities that can improve food security. Some are considered in this section.

#### 3.3.1. Creating more market transparency

Global food security is under serious strain when the tide of market developments suddenly turns, prices explode, and importing countries face unexpected difficulties obtaining access to supplies. Market transparency, by allowing governments and private agents to prepare for changing market conditions, can greatly help to avoid such situations. Following the experience with recent food price spikes, the international community is engaged in efforts to improve information on market developments. As initiated by the G20 Agricultural Ministerial in 2011, a new international AMIS for major food crops has been created. Housed in the FAO headquarters in Rome, it is supported by a number of international organizations. This is a highly welcome development that deserves full support.

The effective functioning of AMIS depends critically on the willingness and capacity of all nations to supply the system with comprehensive, timely and accurate data. Of particular importance are data on stockholding, both public and private. Statistics on stockholding are notoriously deficient in many countries or are not made available publicly. Governments must get their act together and provide this crucial data, including information on stock levels on farms and in commercial enterprises. The private sector needs

to understand that it has a serious responsibility to provide adequate data. A firm commitment by as many countries as possible to cooperate closely with AMIS and provide full access to data could make an important contribution to strengthening global food security through improved transparency. The Rapid Response Forum, consisting of senior officials from countries participating in AMIS, provides the opportunity to exchange information on critical market developments and discuss appropriate policy responses.

#### 3.3.2. Support for emergency reserves

Attempts at taming volatility on global food markets through internationally agreed buffer stocks or similar arrangements have failed miserably in the past. Large-scale national stock policies are equally ineffective in dampening price fluctuations on domestic markets and their cost-benefit ratio is highly questionable. Targeted humanitarian emergency stocks of food, however, are a different matter. Their purpose—implicit in the term “emergency”—is not to achieve greater price stability on markets but to guard against a breakdown of physical supplies and the resulting serious threat to food security. Supplies can break down physically for a number of reasons, including warfare, natural catastrophes, interruption of transport channels, or export bans imposed by traditional suppliers. In situations of this sort, economic hedges such as futures contracts do not help. The only effective remedy to guard against a breakdown of physical supplies is stockholding, preferably not too distant from where the food is needed.

The size of these emergency stocks can be limited as alternative sources of supply can typically be mustered after a while. In addition, not all of the population in the region concerned has to be catered for, as some pipeline supplies will normally still be available—although they will tend to enter the market only at rapidly surging prices. It is the poor who greatly suffer in such a situation and they should be the target population for emergency reserves. Depending on conditions in the territory concerned, emergency stocks may be most effective either at the national or regional level.

Designing, setting up and maintaining emergency reserves is costly. Also, systems must be created and implemented to distribute food from the reserve promptly, efficiently, and in a fair manner. None of this is cheap. The international community can help improve food security in times of crisis by supporting the establishment of emergency humanitarian food reserves.

#### 3.3.3. International support for social safety nets

Risk management has always been an important issue for farmers, particularly in times when agricultural commodities are in ample supply and prices are depressed. As food markets show perceptible signs of scarcity, risk management for consumers must be given more attention. For high-income families this is not a grave issue as food expenditure is only a fraction of their overall budget. However, the livelihood of poor families, who can spend 70% or more of their income on food, is seriously threatened when food prices suddenly explode. Managing that risk should be considered one of the most important elements of any strategy to improve global food security.

Social safety nets are an effective approach to managing risks for vulnerable people, including the risk of rocketing food prices. They serve to make purchasing power available to those in need. Several variants in design have been applied or tested and overall experiences are positive. It is a difficult, yet manageable, task to develop an appropriate mechanism that achieves careful targeting of the needy, avoids distortions in incentives, and secures effective implementation. The practical experiences gained in various parts of the world provide useful guidance. Where the focus is on managing the risks of food insecurity, several alternative approaches can be considered. A system of global food stamps is a policy worthy of particular attention.

Establishing and financing social safety nets, including the institutional and physical infrastructure required for their successful operation, is a demanding task for developing country governments. Moreover, funding the operation of a safety net over a potentially extended period during which protection against exploding food prices is needed may well be beyond a government's capacity. International assistance in both the design and funding of social safety nets can make a helpful contribution to improving food security.

#### 3.3.4. Financial solidarity

In response to the traumatic experiences of recent years, the international community has resolved to intensify efforts to improve food security in poor countries. Several avenues for progress in this direction are being explored and some are already in the process of being implemented, including elements discussed in this paper. A number of countries have pledged to make financial contributions to underpin these measures. Indeed, implementing projects such as emergency reserves or social safety nets requires substantial

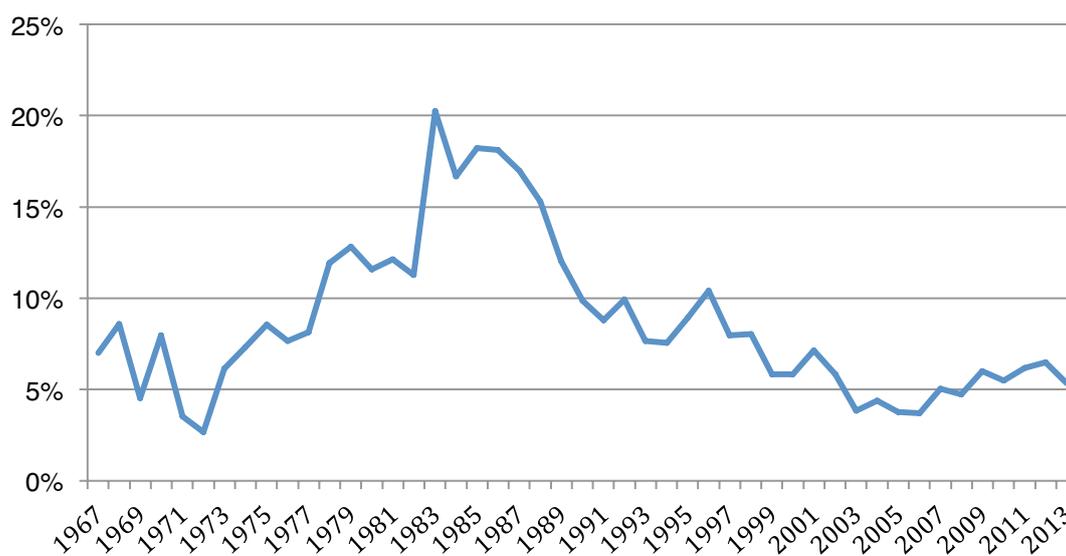
financial investments, as does support to overcome rural poverty through strengthened agricultural development, in particular among smallholders. Mitigation and adaptation to climate change requires additional resources that many developing countries will find difficult to muster. What is now needed is a framework that sustainability secures these efforts.

Past experiences—when a somewhat similar situation of high food prices on international markets in the early 1970s caused grave concerns regarding world food security—must not be repeated (see Figure 1). At that time, all manner of initiatives were launched and large funds for development assistance targeted at agriculture were made available.

The share of agriculture (and forestry and fisheries) in total official development assistance (ODA), which hitherto had been in the order of magnitude of 7%, reached a peak of around 20% in the early 1980s. However, when the situation in world food markets subsequently calmed down, the international community moved on to other issues and the share of agriculture in ODA declined to less than 5% in the early 2000s and only marginally above 5% more recently (see Figure 3). It would be a tragedy if the current resolve to do more for agriculture and food security in poor countries were again to fade away.

It is also advisable to ensure that funds made available in response to recent experiences are additional to development assistance already planned. There is a tendency to engage in multiple earmarking for a given financial flow. Thus it would be desirable to create a new financial instrument that is clearly separate from other forms of development assistance and that is related to the trade issues discussed in this paper.

**Figure 3: Share of Assistance to Agriculture, Forestry and Fisheries in Total ODA**



Source: OECD-(2015)

One option that could possibly achieve this goal might be the creation of an instrument that would be an expression of financial solidarity; establishing a relationship between what governments in rich countries do for their farmers and assistance to agriculture and food security in poor countries. This instrument would come in the form of an agreement in which all developed and emerging countries provide a given amount of financial support for measures aimed at improving food security and fostering agricultural development in low-income countries in particular need of support. The agreement would have three major elements: (i) allocation of the financial contributions to donor countries; (ii) definition of the group of recipient countries; and (iii) choice of a mechanism through which funds are disbursed.

(i) In order to express solidarity with what is done for farmers in the donor countries, financial contributions would be allocated in proportion to the magnitude of their domestic support to agriculture. An appropriate indicator would be the level of overall trade distorting domestic support (OTDS) currently provided.<sup>5</sup>

The percentage of OTDS to be contributed to the new instrument would have to be agreed in negotiations. At present, total ODA to agriculture is in the order of magnitude of US\$10 billion. OTDS currently provided to agriculture in all developed and emerging countries is probably in the order of magnitude of US\$200 billion. Contributions of 1% of OTDS in each donor country could thus provide new funds for support to agriculture and food security in target countries that would enable an expansion of ODA to agriculture by around one-fifth.

(ii) Recipients in particular need are countries with low levels of income that have difficulties with providing their poverty-stricken population with sufficient food, and hence where food insecurity is prevalent. A list of such countries would have to be established in the course of the negotiations based on agreed quantifiable criteria.

(iii) As the WTO is not geared to implement development projects, a different institution would have to be chosen to disburse the funds under this solidarity instrument based on relevant experience and track record. Projects to be financed could be identified in accordance with a set of guidelines to be agreed in the context of establishing this new instrument. Measures that contribute to improving food security should receive priority attention.

This type of instrument of financial solidarity with countries in need of improving issues related to food security would be an innovative approach to the problem. It would constitute a direct response to one of the biggest challenges to have emerged in the world's food and agricultural sector in recent years.

### 3.4. Fostering Agricultural Productivity

Fostering higher agricultural productivity, specifically in least developed countries, is a particularly promising approach to advance living conditions in rural areas, reduce poverty and improve food security. At the same time, it is the most adequate response to the shift from demand- to supply-constrained circumstances in global agriculture as well as concerns regarding the world's capacity to feed a growing population. If truly focused on strengthening productivity (rather than artificially supporting output expansion) it is also a way to improve global food security without generating trade distortions. A top priority for the international community should thus be to increase investment in agricultural innovation systems (AIS), with a particular focus on developing countries and especially smallholder agriculture in least developed countries.

More can and should be done to strengthen international, regional and national systems of research and development (R&D) in agriculture as well as extension services, farmer education and training activities. Greater emphasis should be placed on developing technologies well-adapted to local conditions, including so-called orphan crops that have received insufficient attention in both public and private R&D. Governments in developed and developing countries should encourage private investment in research and technology development, including through targeted financial incentives, well designed public-private partnerships, and innovative financing mechanisms for venture capital.

Developed and developing country governments as well as international organizations should be encouraged to provide reliable financial support to research and innovation, in particular where the private sector is not sufficiently active. Cross-border technology transfer can be enhanced to address transnational issues, which include trans-boundary diseases, climate change and water scarcity. The system of the Consultative Group on International Agricultural Research (CGIAR), with its manifold research centres, has examined and revised its approach recently. It has great potential to engage in R&D in partnership with national and regional research systems.

Well-functioning input markets, including for yield-enhancing inputs such as fertilizers, are an important requirement for farmers to gain access to improved production technologies. Subsidies for such inputs may, as a temporary measure, facilitate the adoption of farming systems that boost productivity. However, if used on a longer-term basis they are likely to lead to distortions and over-intensification with negative environmental implications. It is therefore important to place the focus on the removal of barriers to the adoption of productivity-enhancing technologies, rather than on the use of input subsidies by developing countries. Secure rights over key production resources, in particular land and water, are a prerequisite for effective incentives to engage in productivity improvement.

<sup>5</sup> In the Doha negotiations on agriculture, use of the concept of OTDS is being considered as an element of domestic support commitments, as reflected in the Draft Modalities of December 2008. OTDS would comprise all domestic support outside the Green Box (and exempt support for agricultural and rural development in developing countries as defined in AoA Art. 6.2). OTDS commitments would become applicable only once the Doha negotiations are concluded but there is no reason for the concept not to be used as a statistical yardstick before the end of the Doha Round.

# 4. Conclusions: Priorities and Next Steps

The present document has originated from discussions among members of an expert group brought together under the E15 Initiative. The main purpose of the work programme was to suggest policy options that respond to new challenges in the area of food and agriculture that were not yet prominent in the minds of negotiators when the Doha Round was launched in 2001. The intention is neither to interfere with the ongoing negotiations nor to suggest modifications of the Doha mandate. The idea is rather to consider options that may be helpful in responding to new challenges that have become increasingly relevant in the past decade, with an emphasis on policies targeting trade as well as equitable and sustainable development.

## 4.1. Priorities

Priorities for policy orientation are shaped by the most pressing challenges of the time. The changing conditions in agricultural markets since the turn of the century have brought to the fore the need to focus more on food security. Hunger and malnutrition are by no means a new phenomenon and have long been a top priority for the international community. Yet the specific food security problems resulting from conditions on international markets for agricultural products have come sharply into focus as a result of the dramatic price peaks experienced in recent years. The international community is now paying renewed attention to the issues surrounding food security—rightly so given the overwhelming importance of mitigating the human suffering caused by a lack of sufficient and reliable access to food. Against this background, placing a priority focus on food security is a must for the international community. At the same time, it can demonstrate what international trade, and the regime governing it, can constructively do for developing countries.

Closely related to that top priority is the emphasis that must be placed on agricultural development in developing and emerging countries. Fostering agricultural development on a sustainable basis, with a particular focus on smallholders in least developed countries, has the double benefit of helping to reduce poverty (with its core prevalence in rural areas) while at the same time contributing to raising global food supplies.

While focusing on these priorities, there is no need to downplay the importance of improving efficiency through making the best and most sustainable use of the planet's resources. A strategy of working towards well-functioning markets, reducing trade barriers and minimizing policy-induced distortions, as well as those resulting from non-competitive behaviour by private operators, can contribute

to improving food security and fostering agricultural development. Functioning international markets help to make food available at the lowest conceivable cost and point towards the most effective use of comparative advantages in each country's agriculture. This is not to say that government policies do not have an important role to play. Markets and trade can only perform their decisive roles if framework conditions are set appropriately and if urgently needed public goods are made available.

## 4.2. Timescale

The policy options discussed in this document have been formulated with these priorities in mind. They are presented here in three sets along a timeline—i.e. short-term, medium-term and long-term. Allocation of the policy options to these three time horizons is based on two criteria: the urgency of the subject matter; and the anticipated time needed to consider and find agreement on the respective policy options.

### 4.2.1. Options for the short term

Primary candidates for an early agreement are provisions that fill the following criteria: governments consider them to be urgent; they have already been identified as helpful steps forward in international fora; they do not affect the balance of rights and obligations across WTO members; and they do not prejudge important elements of the final package of the Doha Round arrangements. Reaching consensus on what to include in an early agreement should be easier the less any modification of existing policies is required. On that basis, some of the options suggested in this document qualify for agreement in the short term.

A direct response to the challenge of improving world food security would be a resolve to establish a new instrument of financial solidarity that establishes a relationship between support to agriculture in developed and emerging countries and assistance to developing countries in urgent need of enhancing food security. Early agreement to work towards an approach of this nature would help to create an atmosphere that facilitates talks on other elements of the global regime for food and agriculture. Serious efforts to find agreement on the desirability of designing such an approach should therefore be considered a top priority.

The urgent aim of improving food security in times of higher and volatile prices on international markets for agricultural products would be served if greater transparency regarding export taxes and restrictions (as well as other trade measures that contributed to the price spike) could

be achieved. The suggestions contained in the draft Modalities of December 2008, calling, among others, for notification within 90 days of the application of an export restriction, including the reasons for such measures and periodic reporting to the Committee on Agriculture of the status of the restrictions, should become an element of an early agreement. This recommendation would not impose changes in existing policies but would help importing countries prepare for a situation of tightening markets. The same can be said for establishing a procedure that would serve to identify whether an exporting country is actually in a situation where it has reason to adopt an export restriction in order “to prevent or relieve critical shortages of foodstuffs” (GATT Art. XI).

Somewhat more demanding would be an agreement to exclude from any restrictions shipments destined to serve as food aid to countries in an emergency. However, the importance of such an agreement for improved food security is so overwhelmingly obvious that it is worth an attempt at finding agreement in the short term. If multilateral agreement on that option cannot be found, it could become an option for a plurilateral arrangement of the “willing” open to future accession by other countries.

Given the close relationship between food security and the use of agricultural commodities for the production of biofuels, it would also be desirable to create as soon as possible more transparency regarding the types and levels of government support to biofuels. Notification to the WTO, either under the ASCM or the AoA, would again not require any changes in existing policies but help gain a better understanding of their nature and of their potential impact on food markets. Agreement on effective notification procedures is another candidate for an early agreement.

More generally, improving the transparency of existing policies is a benign approach that helps governments respond constructively to current developments without any need to alter existing policies and without changing the balance of rights and obligations across countries. Another candidate for early agreement is thus the adoption of the suggestions for improved monitoring and surveillance contained in Annex M of the draft Modalities of December 2008 (proposing revisions of Article 18 of the AoA). In that context, and as foreseen in Annex M, it could be agreed to make additional resources available for those developing countries that have difficulties preparing the required notifications. In the same context, it could be agreed to expand somewhat the information on agricultural policies in the Trade Policy Reviews.

Overall, providing more resources to assist developing countries in implementing provisions of existing arrangements would be a positive element of an early agreement. Another concrete measure along those lines is to help developing countries overcome any capacity constraints they face in establishing effective SPS regimes. In particular, assistance to build the capacity to implement international SPS standards, guidelines, and recommendations is a desirable route towards better market integration, here again without interfering with the existing balance of rights and obligations. Resolve to increase

support to the Standards and Trade Development Facility is a conceivable element of an early agreement.

#### 4.2.2. Options for the medium term

In the medium-term, policy options can be considered that require more preparation in both conceptual and negotiating terms. That does not mean that discussion on these options cannot begin right away. However, as these options do not fill all the criteria outlined above to become part of an early agreement, it may be the case that developing these options may require more time.

Policy options of that nature include the binding of export taxes as a high priority; clarification and amendment of Green Box rules (including those relating to smallholders in least developed countries); and improved transparency regarding SPS measures.

#### 4.2.3. Options for the long term

While the Doha negotiations continue, thought can already be given to issues that have become increasingly relevant for trade rules under the WTO since the original mandate for the Doha negotiations was agreed. These policy options could become subjects of a new work programme and have been allocated here to a longer time horizon.

Among the options discussed in section 3, this work programme should consider introducing new incentives for compliance with monitoring requirements and respect of deadlines such as ineligibility for benefits (e.g. exclusion of Green Box and Development Programmes from constraints on domestic support) until eligibility has been affirmed; introduction, with high priority, of disciplines on support for biofuels; and clarification of the conditions under which the WTO permits border measures designed to prevent carbon leakage and equivalent impacts.

Some of the options considered in this document go beyond trade matters as traditionally dealt with in the WTO and they might be better dealt with in other international fora. This is particularly the case for a number of measures aiming at greater food security such as: improved market transparency; support for emergency reserves; and assistance for strengthened social safety nets. It also applies to the various measures that can foster agricultural productivity. The agricultural component of the G20 is working on these and related issues supported by the relevant international organizations, including the WTO. It is important that consensus found in the G20 framework feed directly into these international organizations, which, based on their mandate and operational capacities, can transform desirable policy options into concrete action.

### 4.3. Process

In response to the extraordinary developments in the world's food and agriculture economy over the last ten years or so, the international community has begun to pay more attention to food security and agricultural issues in developing countries. Action is being considered, and to some extent already implemented, in various fora. However,

in the international trade arena immediate response has been complicated by the ongoing negotiations under the Doha agenda. In the interest of a thriving trade regime and of well-functioning markets for food and agricultural products, these negotiations should continue and reach a fruitful conclusion as soon as possible. Placing an explicit focus on food security can help to demonstrate that the international trade regime is sensitive to the needs and interests of the poorest countries. It is therefore desirable to reflect on ways in which policy options such as those suggested in this report can be considered without retarding in any way the Doha negotiations.

In line with the Bali Ministerial Declaration and subsequent decisions of the WTO General Council, WTO members are currently seeking agreement on a work programme on the remaining Doha Development Agenda issues. That programme could possibly include work on policy options such as those discussed in this paper, including work towards a new instrument of financial solidarity. Should deliberations under a work programme of this nature result in agreement on any given item before the Doha Round is concluded, that item should, if appropriate, be implemented right away. Alternatively, it could be put on the shelf for later inclusion in a Doha agreement. Some elements suggested in this report will require more time to design and negotiate and may reach maturity only after the Doha round is concluded. This could especially be the case for items earmarked as policy options for the long-term.

Finding agreement on a work programme of this nature would send a positive signal. It would indicate that the international trade regime has the capacity to respond to acute challenges without diminishing efforts to come to grips with ongoing negotiations. The new developments in food security and agriculture that have occurred since the beginning of the 21<sup>st</sup> century are worth a serious attempt to move beyond business as usual.

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The papers commissioned for the E15 Expert Group on Agriculture, Trade and Food Security can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Adapting the WTO Agreement on Agriculture and the SPS Agreement</b>					
<b>1. Transparency regarding export taxes and restrictions.</b>	Short Term	AoA Art12. calls for consultation and advance notice (only developed countries and developing exporters)	Export taxes and restrictions often not notified or notifications delayed, no prior notice or consultations	Build trust among WTO members and raise awareness of mutual advantages to be gained through increased transparency	WTO members
<b>2. Procedure to identify whether an export restriction is needed for domestic food security reasons.</b>	Short Term	GATT Art XI:2(a) allows export prohibitions or restrictions "to prevent or relieve critical shortages of foodstuffs"	No such procedure established, requirement not enforced in practice	Build trust among WTO members and raise awareness of mutual advantages to be gained through increased transparency	WTO members
<b>3. Exclude from export restrictions shipments destined to serve as food aid in an emergency</b>	Short Term	G20 leaders agreed declaration 2011	Not adopted at WTO	Revisit issue, building on current broader interest in trade and food security at WTO	WTO members
<b>4. Binding of export taxes.</b>	Medium Term	Not bound	Many exporting countries want to see market access barriers addressed first	First adopt short-term policy options such as improved transparency on export taxes + restrictions; address as broader discussion on balance of commitments undertaken by exporters, importers	WTO members
<b>5. Transparency regarding government support to biofuels.</b>	Short Term	Ethanol and biodiesel support notified separately at WTO (or not at all)	Detailed information on biofuels support unavailable	Build on current concerns about improving data and transparency on farm support at WTO	WTO members
<b>6. Disciplines on support for biofuels.</b>	Long Term	Support for biofuels is subject in principle to AoA and ASCM requirements	No biofuels-specific domestic support commitments	Negotiate specific disciplines limiting the extent to which biofuels can benefit from trade-distorting support	WTO members

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>7. Clarification and amendment of Green Box rules.</b>	Medium Term	Payments for “public goods” currently treated the same as other types of Green Box subsidies	Different treatment for “public goods” payments such as general services payments and environmental payments, relative to e.g. income support payments	Address as part of broader negotiation over reformed farm subsidy disciplines, possibly as part of future “built-in agenda”	WTO members
<b>8. Adoption of suggestions for improved monitoring and surveillance in Annex M of the draft Modalities.</b>	Short Term	Annex M tabled 2008 in Rev.4	Members currently disagree over status of Rev.4	Seek agreement on “early harvest” of Annex M / incorporation into eventual deal	WTO members
<b>9. Incentives for compliance with monitoring requirements and respect of deadlines.</b>	Long Term	AoA Art.18 sets out requirements for the review process, including notifications	No or minimal sanctions or incentives for timely compliance with monitoring and reporting requirements	Members could explore this policy option as part of a broader discussion on transparency and monitoring at the WTO	WTO members, WTO Committee on Agriculture, WTO Secretariat
<b>10. Increase support to the Standards and Trade Development Facility.</b>	Short Term	Developing countries face constraints in establishing effective SPS regimes	Ensuring developing countries can build capacity to implement SPS standards + guidelines could help producers integrate effectively into regional and global markets	Governments agree to increase support to the Standards and Trade Development Facility as an “early harvest” on trade	WTO members

#### Preparing WTO Rules for the Future

<b>11. Clarification regarding border measures to prevent carbon leakage.</b>	Long Term	No clarity at present over how such measures would be treated under WTO law	Risk that dispute settlement process substitutes for agreed solution in absence of informed debate, negotiation	Build trust and awareness of mutual benefits of agreed solution through debate in margins of Committee on Trade and Environment	WTO members, WTO CTE, UNFCCC
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#### International Cooperation to Improve Food Security

<b>12. Improved market transparency.</b>	Long Term	Agricultural Market Information System (AMIS) aims to promote increased market transparency among G20 countries	More and better data needed for AMIS to function properly	Build trust among G20 countries, raise awareness of mutual advantages to be gained through increased transparency	G20, AMIS, private farms and commercial enterprises
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<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>13.Support for emergency reserves.</b>	Long Term	Existence and effectiveness of emergency reserves varies across countries and regions	World Food Programme supported development of pilot project in West Africa; also ASEAN collaboration on rice reserves	G20 action to build on experience with pilot projects etc. since 07-11 food price spikes	WFP, G20
<b>14.Assistance for strengthened social safety nets.</b>	Long Term	Existence and effectiveness of social safety nets varies across countries and regions	ILO work on social protection floor, but no global framework to support strengthened social safety nets exists	A "global food stamp scheme" could support purchasing power of poor consumers and establish a framework to support strengthened social safety nets without distorting trade	ILO, World Bank, WFP, UNDP
<b>15.Establish a new instrument of financial solidarity.</b>	Short Term	No such instrument currently exists	Agricultural productivity currently financed through CGIAR system, and work of IFAD, FAO, plus bilateral donor support: no link to trade-distorting support levels	G20 countries could provide political impetus in support of this initiative, with follow up through WTO and other relevant agencies	WTO members, G20, CGIAR, IFAD, FAO
<b>Fostering Agricultural Productivity</b>					
<b>16.Increase investments in agricultural innovation systems.</b>	Long Term	Investments in agricultural innovation systems funded publically through CGIAR system, universities etc. and privately (R&D spending)	New financial solidarity instrument or other innovative financing mechanisms could establish more secure financial basis for investment in agricultural innovation systems	G20 countries could provide political impetus in support of this initiative, with follow up through WTO and other relevant agencies	WTO members, G20, CGIAR, IFAD, FAO
<b>17.Removal of barriers to the adoption of productivity enhancing technologies.</b>	Long Term	Security of rights over key production resources (land, water etc.) vary across countries and regions	In many countries rights over key production resources are not secure, meaning agricultural productivity is affected	Governments develop adequate systems to safeguard rights over productive resources, especially for small farmers and vulnerable rural communities	National governments

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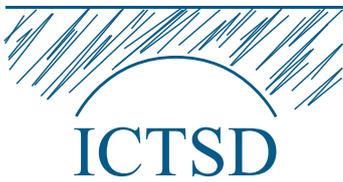
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# Enabling the Energy Transition and Scale-up of Clean Energy Technologies: Options for the Global Trade System

Policy Options Paper



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# Enabling the Energy Transition and Scale-Up of Clean Energy Technologies: Options for the Global Trade System

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on behalf of the E15 Expert Group on Clean Energy Technologies and the Trade System

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Clean Energy Technologies and the Trade System. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15Initiative and authored by group members. Ricardo Meléndez-Ortiz was the author of the report. Ingrid Jegou was the lead writer and Mahesh Sugathan contributed significantly to the final paper. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15Initiative:  
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# Abstract

With the challenges of access to energy, energy security, and the imperative of climate change becoming more pronounced in recent years, interest in clean energy has surged. Mitigation efforts to limit global warming to no more than 2 degrees Celsius or 1.5 degrees Celsius as compared to pre-industrial levels will primarily hinge on a rapid and massive scale-up of clean energy. The December 2015 Paris Agreement on climate change is fundamentally about fostering an urgent and massive transformation to a low carbon or carbon-neutral energy base for the world economy. The urgent need to shift to a cleaner energy mix has thus made reform of the supply and use of energy a key policy priority for the global community. The world has witnessed a spectacular growth of clean energy technologies (CETs) in the past two decades, most of it in response to purposeful international, national, and subnational policies. The result is today's global and dynamic clean energy industry, encompassing manufacturing, services, and knowledge, mostly organized in international value chains, and highly dependent on trade and investment. All of this activity, however, has highlighted the shortcomings and obstacles of uncoordinated policies and inconsistent rules. The present paper seeks to examine the ways in which current trade policies and frameworks enable or hold back the pressing need for further development of clean energy. Based on this analysis, it identifies a set of policy options for the global trade system to support the scale-up of CETs. A first set

of options is related to addressing systemic issues with a view to enhancing trade governance for renewable energy and climate policies in the context of the WTO framework. These proposals include: (i) an amendment of GATT rules; (ii) temporary waivers; (iii) an interpretive understanding to clarify existing obligations; (iv) a plurilateral agreement; and (v) a moratorium on dispute settlement in the area of clean energy. A second set of options addresses reform of existing rules and the formulation of new rules aimed at strengthening markets for CETs as well as responding to the need for any additional policy space that may be required to pursue mitigation and other sustainable development goals through the scale-up of clean energies. The options on strengthening markets consider: (i) scenarios for tariff liberalization in CETs; (ii) removing barriers to clean energy services; and (iii) addressing regulatory issues such as non-tariff barriers and clean energy access to networks. The options on policy space focus on three areas that could benefit from greater clarity, predictability, and flexibility: (iv) subsidies; (v) local content requirements; and (vi) trade remedies. Many of the options explored in the paper are motivated by the wish to refrain from unnecessarily relying on the WTO's dispute settlement mechanism to define the limits on how climate action is allowed to interfere with trade. These options range from ambitious proposals for comprehensive reform of the trade system to more gradualist, short-term approaches to support the deployment of clean energy globally.

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Abbreviations	
AD	anti-dumping
APEC	Asia-Pacific Economic Cooperation
ASCM	Agreement on Subsidies and Countervailing Measures
CET	clean energy technology
CO <sub>2</sub>	carbon dioxide
COP	Conference of the Parties
CVD	countervailing duty
DDA	Doha Development Agenda
DSU	Dispute Settlement Understanding
EGA	Environmental Goods Agreement
EGS	Environmental Goods and Services
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GHG	greenhouse gas
GPA	Government Procurement Agreement
HS	Harmonized System
LCR	local content requirement
MEA	multilateral environmental agreement
MFN	most favoured nation
NTB	non-tariff barrier
PV	photovoltaic
RTA	regional trade agreement
SETA	Sustainable Energy Trade Agreement
TBT	technical barrier to trade
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UNFCCC	United Nations Framework Convention on Climate Change
WTO	World Trade Organization

# Executive Summary

A global scale-up of clean energy carries several benefits such as enhanced energy access, increased energy security, and, not least, enabling rapid progress in climate change mitigation through reductions in greenhouse gas emissions driven by decarbonization of energy supply use. Growing political commitment to these goals as well as the introduction and expansion of clean energy policies worldwide have driven unprecedented levels of activity in the sector. This has happened both in terms of investments as well as the development of clean energy technologies (CETs) reflected by a surge in patenting activity. New initiatives such as that of the Solar Alliance of 100 sunshine-rich countries announced at the COP21 Climate Conference in Paris in December 2015 will further spur an expansion of clean energy investments.

## Background

The global and highly dynamic clean energy sector today comprises manufacturing, services, and knowledge-based industries organized along global value chains and heavily dependent on trade and investment policies. The lack of coherent and coordinated trade and investment policies and governance frameworks has resulted in numerous barriers and obstacles that add unnecessary risks to investments, complicate the organization of supply chains, and add costs at borders and behind, all delaying the scale-up of clean energy worldwide. The growing number of trade remedy cases involving both anti-dumping as well as anti-subsidy measures add to tensions among trading partners while increasing uncertainty and exerting a chilling effect on investment. A further examination of the ways in which trade policies and frameworks can constrain or encourage clean energy scale-up is therefore required.

While initiatives at the regional and plurilateral level to reduce barriers to trade in CETs have been launched, the lack of progress in the WTO's Doha Round has proven to be a serious hindrance to more comprehensively addressing trade-related obstacles at a multilateral level. The WTO Ministerial Conference of 2011 and the Davos declaration on the Environmental Goods Agreement (EGA) speak of "the need to look at ways that may allow Members to overcome the most critical and fundamental stumbling blocks."

It is against this backdrop that the E15 Expert Group on Clean Energy Technologies and the Trade System was established, jointly convened by ICTSD with Friedrich Ebert Stiftung and Chatham House in partnership with the World Economic Forum. The objective of the Expert Group was to examine the major challenges and opportunities for expanding the use of CETs through trade. The mandate was

to identify and put forward policy options for the global trade system to support the scale-up of CETs and respond to the urgency of the climate change imperative.

This paper presents the main policy options discussed by the Expert Group in 2013–2015. A first set of options is related to addressing systemic issues with a view to enhancing trade governance for renewable energy and climate policies in the context of the WTO framework. A second set of options addresses reform of existing WTO rules and the formulation of new rules aimed at strengthening markets for CETs as well as responding to the need for any additional policy space that may be required to pursue mitigation and other sustainable development goals through the scale-up of clean energies. While offering the options for consideration, the Group clearly recognizes the unpredictability and limits of WTO litigation as a strategy to pursue these goals. Indeed, many of the options explored in the paper are motivated by the wish to refrain from unnecessarily relying on the WTO's dispute settlement mechanism to define the limits on how climate action is allowed to interfere with trade and vice-versa.

## Policy Options

The first category of options outlined in the paper attends to systemic reform. The proposals include: (i) *an amendment of GATT rules* to ensure that policies supporting the development and scale-up of clean energy for climate change mitigation purposes are more explicitly permissible and thus sheltered from challenge; (ii) *temporary waivers* (which could be coupled with an amendment) that legally waives the application of a stated WTO obligation; (iii) *an interpretative understanding* that clarifies the meaning of existing WTO obligations and which could be "taken into account" when interpreting a treaty; (iv) *a plurilateral agreement* between a group of countries regarding how they will interpret WTO rules in trade relations with each other; and (v) *a moratorium on dispute settlement* in the area of clean energy.

All of these systemic options vary in their degree of challenges in terms of ease of implementation. For instance, a negotiated amendment, while providing legitimacy not present in a litigated settlement, would also require consensus among WTO members on the need for reform as well as a two-thirds-majority agreement on a new text. The process could take several years and run the risk of creating parallel rules, as it would only bind the members that have accepted it. Waivers would similarly face difficulties in securing broad agreement among WTO members. While also challenging, there are successful precedents regarding interpretative understandings that have influenced dispute settlement. A plurilateral agreement could be easier to achieve, as it would not require the same degree

of consensus as the other options. However, the impact of such an approach would depend both on the scope of the agreement and whether its parties include important players in the WTO. A number of group experts have also advocated the idea of plurilaterals outside the trade system in the form of “climate clubs” involving major greenhouse gas emitting countries. These experts consider a general exception to the most-favoured-nation clause allowing such clubs to be a simpler pathway to pursue urgent climate goals as compared to the difficulty of amending several WTO provisions. In addition, given the risks of WTO litigation, the option of a moratorium on clean energy disputes was also discussed. The moratorium would permit temporary breaches of WTO rules by members in the interest of climate change mitigation. While more feasible than an amendment of WTO rules, it would raise issues of coherence.

The second category of options concerns reform of existing WTO rules and the formulation of new rules under two broad headings: strengthening markets and policy space.

First, as regards the strengthening of markets for CETs, the paper outlines the rationale and process behind the following options identified by the Expert Group: (i) different scenarios for *tariff liberalization* of CETs and addressing non-tariff measures under multilateral, regional, plurilateral, and unilateral schemes; (ii) removing barriers to *clean energy services* through initiatives that involve the development of better classifications, the identification of products and activities relevant for the supply of CETs, and the actual implementation of trade reforms with a coordinated approach to clean energy goods and services liberalization; and (iii) addressing *regulatory issues* such as domestic regulation in services, standards and conformity assessment measures, renewable energy and third party access to networks and fixed infrastructure, cross-border clean energy trade, and the expansion of network capacity. The possibility of including an annex to the General Agreement on Trade in Services (GATS) or a reference paper to clarify and develop the above rules is explored, as are the lessons that can be drawn from innovative approaches to clean energy in plurilateral and regional agreements.

Second, concerning the additional policy space and associated measures that may be required to pursue climate change mitigation and other sustainable development goals, the Expert Group specifically looked at three areas that could benefit from greater clarity and predictability as well as “flexibility” with respect to trade rules. These are subsidies, local content requirements, and trade remedies.

(i) On *subsidy reform*, the most ambitious measure would be an amendment of the Agreement on Subsidies and Countervailing Measures (ASCM), and/or Article XX of the GATT to ensure that policies supporting the development and scale-up of clean energy for climate change mitigation purposes would be more explicitly permissible and thus sheltered from challenge. However, the difficulties of this systemic approach were recognized. Other options for reform that were proposed include: (a) an interpretative understanding to resolve the ambiguity regarding the question of whether the general exception under GATT, Article XX, applies to the disciplines in the ASCM; (b) an alternative approach that would involve clarification of the concepts “benefit,” “financial contribution,” and “specificity” in the ASCM; and (c) a waiver from the ASCM for clean energy policies under certain specific conditions, including

the reform of policies that undermine the objectives of the waiver, in particular fossil fuel subsidies.

(ii) On *local content requirements* (LCRs), despite weak evidence concerning the environmental benefits of such measures as well as their incompatibility with WTO rules, they are prevalent in a number of WTO members around the globe. There is thus a need to further review or clarify existing WTO rules as a priority issue. Options such as a gradual phasing out of LCRs were explored but found little support in the Group. An alternative option would be to have an interpretative understanding of the ASCM to facilitate the conversion of ASCM-inconsistent LCRs into other kinds of WTO-consistent measures. An example would be to presume that subsidies conditional on providing benefits to the economy, such as training or hiring local workers and technology transfer, would be presumed to be consistent with WTO rules provided they are non-discriminatory and do not violate MFN provisions.

(iii) Finally, on *trade remedies*, the Group put forward options to be pursued in the short and long term in the following areas: (a) reform of the WTO rules governing anti-dumping and anti-subsidy measures to achieve a better alignment with normal competition or antitrust rules; (b) enforcement of existing laws, including, for instance, WTO anti-dumping provisions that call for calculations to take account of declining costs related to learning curves spread over the product cycle; and (c) other options considered feasible in the short to medium term include limiting the level, time, and scope of trade remedies on clean energy, as well as introducing a criterion on climate change in national public interest tests. These options could be explored under the WTO, unilaterally, or within the context of regional trade agreements or a sectoral agreement such as the EGA. In addition, a peace clause on trade remedies (or their elimination) in the clean energy sector could be applied among like-minded countries.

Members of the group also argued during the E15 deliberations that it might be more desirable to seek a universal response cutting across sectors, or make small adjustments, rather than carve out CETs as a special sector. Moreover, for many of the options, the merits of more regulation as against enabling greater global competition will also need to be weighed up. In the case of plurilateral agreements, how these agreements might evolve over time, for example in terms of their scope and coverage as well as the willingness and ability of new entrants to accede, including developing country WTO members with sensitivities to be balanced over differentiated treatment, are all issues which will warrant further consideration and analysis.

The main policy options are presented in Annex 1 in a summary table structured over a short to long-term time horizon. The latter include ambitious proposals for comprehensive reform of the trade system to support the scale-up of CETs, whereas the former offer a gradualist and potentially more feasible approach in the immediate term to respond to the urgent imperative of climate change mitigation.

# 1. Introduction: Why is this important?

Scaling-up the use of clean energy worldwide is related to multiple potential benefits and sustainable development gains. These primarily include: enhanced access to energy for underprivileged populations by addressing deficient energy supply (energy poverty); (ii) increased energy security by lessening dependence on unreliable sources; and thirdly—indeed the current overriding driver behind the development and growth of clean energy technologies (CETs)—combating climate change through the mitigation of greenhouse gases (GHGs) in the most critical emitting sector of economic activity, the supply and use of energy. Climate change, in addition to being perceived as a present and catastrophic danger to life on earth,<sup>1</sup> has also been recognized as “the greatest economic challenge of the 21st century.”<sup>2</sup> Addressing the causes of climate change hinges primarily on a relatively rapid and massive shift to a cleaner energy mix.

The world has witnessed an unprecedented and spectacular growth of CETs in the past two decades, most of it as a response to purposeful international, national, and subnational policies. A critical moment of change came about with the negotiation and enactment of the Kyoto Protocol (1997–2005) linked to the United Nations Framework Convention on Climate Change (UNFCCC). Detailed research evidences the surge in technological development at that time by using customs classification to look into patents filed for the six dominant CETs (UNEP, EPO, and ICTSD 2010). The trend has since continued, spurred both by emerging policies and efforts to tackle climate change, but also by a renewed determination of the international community to provide “sustainable energy for all,” backed up by specific political commitments, ensuing programmes, and new financing. A dramatic growth in public and private investment has thus been documented during these past years, with resilience even during the global economic crisis.<sup>3</sup>

Going forward, the December 2015 Paris Climate Conference (COP21) of the UNFCCC has seen the announcement of bold and grandiose initiatives to take the scale-up of CETs to a much higher order of magnitude to reach the ambitious mitigation targets set in the Paris Agreement. On the public sector side, India intends to launch an International Solar Alliance of over 100 sunshine-rich countries. For its part, the US has facilitated the

formation of the Breakthrough Energy Coalition, a group of the world’s most influential 28 investors determined to fuel innovation and development by massively financing companies that have the potential to deliver affordable, carbon-free power from the research lab to the market.

At the country level—both national and subnational—a vast and wide innovative policy effort involves macro, fiscal, energy, industrial, science and technology, employment and trade tools, among others. The result is today’s global and remarkably dynamic clean energy industry, encompassing manufacturing, services, and knowledge, mostly organized in international value chains, and highly dependent on trade and investment.

All this activity has highlighted the shortcomings, incoherencies, and obstacles of uncoordinated policies and frameworks. Rules are working at cross-purpose hindering expansion and compromising the efficient use of resources; and markets are rigged with obstacles that add unnecessary risks to investments, complicate the organization of supply chains, and add costs at borders and behind, all delaying the scale-up of clean energy worldwide. A surge in cases of both anti-dumping and anti-subsidies, as well as in local content requirements (LCRs), specifically targeting CETs, is indicative of growing tensions. Recurring to dispute settlement and anti-dumping investigations and duties are options that are costly, associated with risks and uncertainty, and have a chilling effect on investment in the sector. Hence the relevance of examining the way in which trade policies and frameworks enable or hold back the pressing need for further scale-up and development of clean energy.

A few modest initiatives have been set off, but much more is needed. Examples of action with potential benefits to CETs include: the Asia-Pacific Economic Cooperation (APEC) agreement on environmental goods, which covers a few components of CETs; President Obama’s 2013 Climate Action Plan, specifically calling for trade liberalization of goods related to CETs; and the ensuing negotiation towards an Environmental Goods Agreement (EGA), also likely to contain a few critical CET-related products, actively being pursued among a group of WTO members since its launch in 2014 in Davos-Klosters with specific reference to combating climate change.

<sup>1</sup> The Working Group II Contribution to the fifth assessment report of the IPCC focuses on “Impacts, Adaptation and Vulnerability” and provides detail on risks across sectors and regions (IPCC 2014).

<sup>2</sup> Christine Lagarde, Managing Director of the IMF, in a speech at the World Economic Forum in Davos, January 2013.

<sup>3</sup> See for example Frankfurt School-UNEP-Bloomberg New Energy Finance (2015).

At the multilateral level, the lack of a successful conclusion to the WTO's Doha Round has for a long time effectively prevented the WTO from taking on new issues. December 2015 also saw action in this respect as negotiators at the WTO Ministerial Conference in Nairobi made a decision to abandon Doha's straightjacket and freed members to pursue new issues through approaches delinked from the resolution of the 14 year old multilateral round. Already the Ministerial Conference of 2011 and the Davos declaration on EGA speak of "the need to look at ways that may allow Members to overcome the most critical and fundamental stumbling blocks."

It is against this backdrop that the E15 Expert Group on Clean Energy Technologies and the Trade System was established, jointly convened by ICTSD with Friedrich Ebert Stiftung and Chatham House in partnership with the World Economic Forum. The objective of the Expert Group was to examine the major challenges and opportunities for expanding the use of CETs through trade. The mandate was to identify and put forward policy options for the global trade system to support the scale-up of CETs and respond to the urgency of the climate change imperative.

The Group sought to examine the following questions: (i) given the crucial role of CETs in addressing climate change, in what ways can the global trade system support the wider use of CETs; (ii) are current international regulatory frameworks and trade-related policies adapted to meeting these challenges; (iii) how can the trade system respond to the specific vulnerabilities and concerns related to climate change of countries at different levels of development; (iv) is there a need to reform the WTO or for non-WTO initiatives to explicitly tackle CETs as a set of particular goods, services, and knowledge that require a differentiated approach; (v) in order to strengthen trade governance in CETs, what options are available for reforming specific WTO goods agreements (such as the Agreement on Subsidies and Countervailing Measures (ASCM) and the Anti-Dumping (AD) Agreement) or the WTO General Agreement on Trade in Services (GATS); and (vi) is there a need for a specific trade agreement on CETs?

This paper presents in some detail the main policy options identified by the E15 Expert Group in 2013–15. It draws upon written material commissioned for the Group and on formal discussions that took place among the experts as well as in open events organized under the E15 Initiative— notably a session at the ICTSD Bali Trade and Development Symposium in December 2013— and the World Economic Forum Regional Meeting in Panama in April 2014. The paper has also benefited from continuous feedback from ongoing programmes in ICTSD and other institutions represented in the Group; the Forum's relevant Global Agenda Council; the SETI Alliance;<sup>4</sup> and the monitoring of the EGA negotiations as well as the evolution of the policy landscape in key countries and global markets.

<sup>4</sup> <http://seti-alliance.org/en>.

# 2. Background to Trade Governance in Clean Energy

## 2.1. Rationale for Treating Clean Energy Differently and for Taking Action

With the challenges of access to energy, energy security, and climate change imperatives becoming more pronounced in recent years, interest in clean energy has surged. In addition, the Paris Agreement on climate change, the new universal treaty reached in December 2015, primarily relies on the multi-faceted pledges of countries to transform their energy systems. Hence, there is now an agreed urgency to phase out the use of fossil fuels, reduce energy intensity, and shift to a cleaner energy mix, making reform of the supply and use of energy a high priority for the global community. While other objectives such as job creation could be pursued through the development of various other sectors of economic activity, including environmentally friendly sectors, climate change is unique in that mitigation efforts to limit global warming to no more than 2 degrees Celsius by 2050 will primarily hinge on the scale-up of clean energy given that 83% of GHG emissions are associated with fossil fuel energy use—making it the largest single contributor to global warming (IEA 2013). In addition, the critical function of energy as an enabler of economic activity worldwide makes this CET scale-up a global policy priority.

As countries strive to accomplish the shift to clean energy—often in combination with other goals such as generating domestic employment and revenue—a range of policies and measures have been put in place, some of which have trade implications. Given that clean energy generation is dependent on fragmented production across jurisdictions and global value chains in equipment as well as in services, trade policy measures at any point along the chain impact costs and the optimal use and sourcing of inputs. This, in turn, impacts the level of investments in and scale-up possibilities of clean energy. Consequently, tensions arise and there is growing recourse to the dispute settlement mechanisms of the WTO, and increasingly to bilateral or regional mechanisms of dispute management. This raises questions as to whether the existing rules are the most adequate to arbitrate and adjudicate.

Currently, there are no energy-specific rules or commitments in the WTO, nor any structured discussion in the WTO on issues related to renewable energy. There are rules pertaining to energy and to CETs in other structures of trade and investment governance, most notably in the context of the Energy Charter or in bilateral and regional trade agreements. Research indicates that a supportive framework of rules as well as targeted trade and investment arrangements could contribute to fostering the scale-up of

renewable energy. Given the considerable potential benefits in terms of sustainable development, and particularly the implications for climate change mitigation, the E15 Expert Group strongly felt that this avenue should be fully explored and sustained.

## 2.2. Vision—Where do We Need to Go?

A prosperous, sustainable, and inclusive future must build on a low or carbon-neutral economy. The world has committed to limiting global warming to below 2 degrees Celsius, thereby reducing the threats related to sea level rise, droughts, floods, spread of diseases, climate-related migration, and major economic losses. Therefore, measures for clean energy expansion required to meet this goal must be supported rather than constrained by other governance frameworks, including trade rules or trade-relevant policies. Whereas due consideration must be given to other important national policy objectives such as poverty alleviation, economic development, and employment—often a precondition for the “buy-in” of clean energy expansion among voting populations—this needs to be done through policy alignment and coherence. Synergies must and can be sought so that clean energy is allowed to be the engine of growth as well as the solution to climate change.

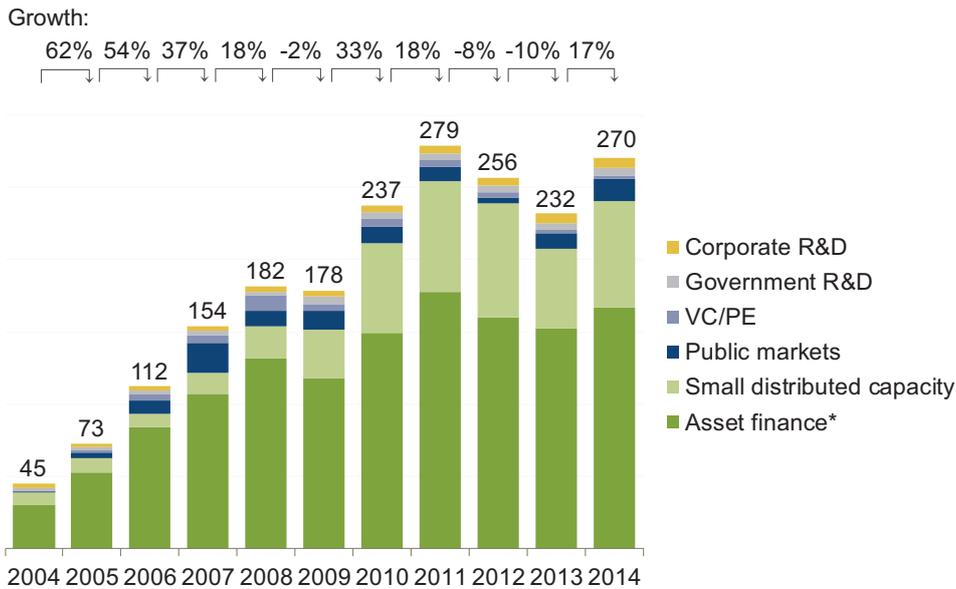
## 2.3. Trends in CET Scale-Up and their Relation to Policies: Surges in Investment, Patents, and Trade Remedies

### 2.3.1. Investments are surging into CETs

Renewable energy continues to see a surge in investments. Global investment in renewable power and fuels (excluding large hydroelectric projects) amounted to US\$270.2 billion in 2014, nearly 17% higher than in 2013 (US\$215 billion) and a significant jump from US\$40 billion a decade earlier in 2004.<sup>5</sup> Developing countries also saw a jump in investments over 2013 by 36% to US\$131.1 billion. Despite a significant fall in oil prices by over 50% in 2014, investment funds to renewables are not expected to be significantly affected (except in certain sectors like biofuels or in oil-exporting countries) given they do not compete for power investment dollars. Indeed, strong technology cost-reductions have continued to drive investment momentum, particularly in solar and wind. Overall investment in solar rose 29% over the previous year to US\$149.6 billion in 2014, while that in wind grew 11% to a record US\$99.5 billion in 2015.

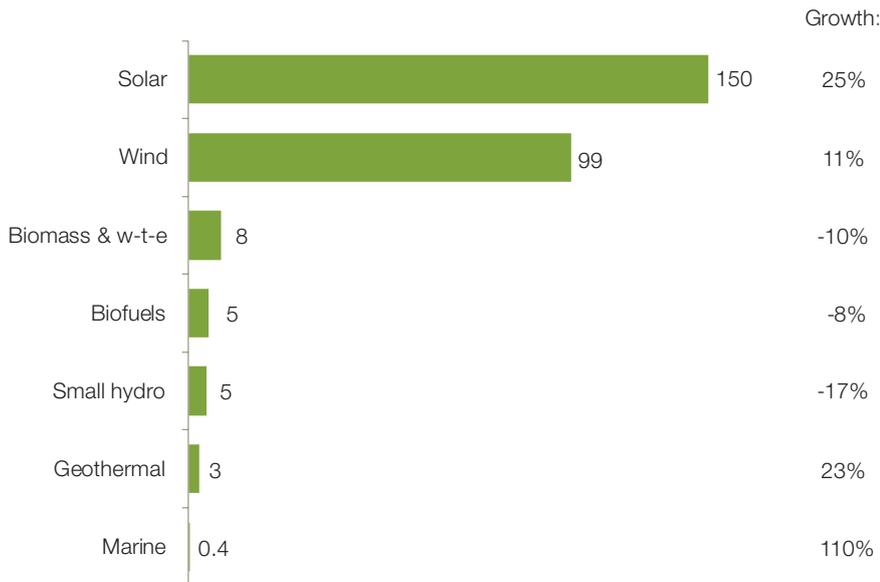
<sup>5</sup> The data in this section is taken from Frankfurt School-UNEP-Bloomberg New Energy Finance (2015).

**Figure 1: Global New Investment in Renewable Energy by Asset Class, 2004–14 (US\$ bn)**



\*Asset finance volume adjusts for re-invested equity. Total values include estimates for undisclosed deals.  
Source: Frankfurt School-UNEP-Bloomberg New Energy Finance (2015)

**Figure 2: Global New Investment in Renewable Energy by Sector, 2014 and Growth on 2013 (US\$ bn)**



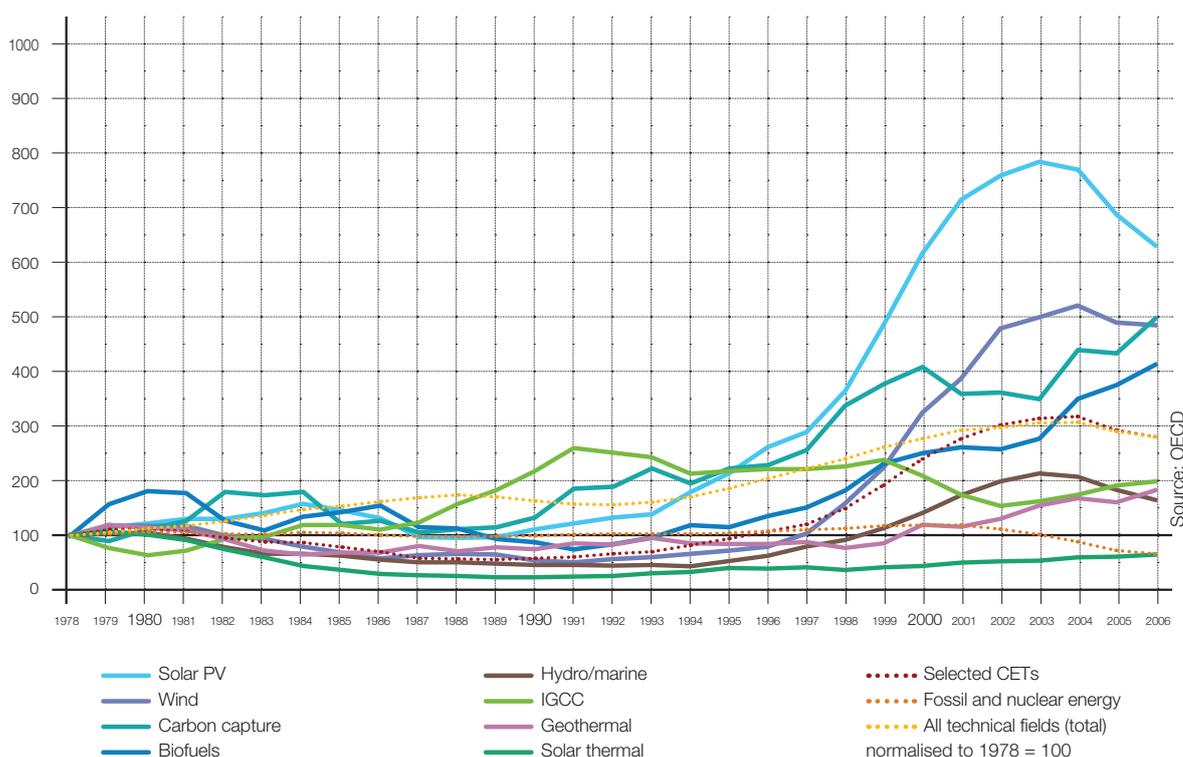
\*Asset finance volume adjusts for re-invested equity. Total values include estimates for undisclosed deals.  
Source: Frankfurt School-UNEP-Bloomberg New Energy Finance (2015)

Despite this growth, wind, solar, biomass and waste-to-power, geothermal, small hydro, and marine power are estimated to have contributed just 9.1% of total world electricity generation in 2014, a small increase relative to 8.5% in 2013. This would be equivalent to a saving of 1.3 gigatonnes of carbon dioxide (CO<sub>2</sub>) taking place as a result of the installed capacity of those renewable sources. However, to put this into perspective, in 2011, CO<sub>2</sub> emissions from the combustion of coal alone increased by 4.9% to 13.7 gigatonnes of CO<sub>2</sub>. Clearly, the scale-up of renewables will need to further accelerate to have a meaningful impact on mitigation targets.

### 2.3.2. Growth in CET patenting activity

There is also clear evidence that patenting activity in CETs is growing. The above-mentioned empirical study (UNEP, EPO, and ICTSD 2010) conducted on the role of patents in the transfer of CETs found that patenting rates (patent applications and granted patents) in selected CETs have increased at roughly 20% per annum since 1997, thereby outpacing the traditional fossil fuel and nuclear energy sources. As Figure 3 below shows, the surge in CET patenting activity coincided with the adoption of the Kyoto Protocol in 1997, which provides a strong signal that political decisions setting adequate frameworks are important for stimulating the development of CETs (ibid).

**Figure 3: Growth Rate of Claimed Priorities Patenting for Selected CETs**



Source: UNEP-EPO-ICTSD (2010)

Patenting has been dominated by six countries, which incidentally figure among the top traders in a range of environmental technologies including CETs and also, with the US, the second largest GHG emitter in the world in terms of absolute emissions (Ge, Friedrich, and Damassa 2014). These countries are Japan, the US, Germany, Korea, the UK, and France. They account for 80% of patent applications in the CETs reviewed by the study with the exception of geothermal, and they also dominate patent filing trends. However, China is the next most important filing destination for actors in the top six countries, which points to its importance as a market for the deployment of CETs.

Despite this domination of the “big six,” a number of other countries emerge as significant actors in selected fields when CET patent data is benchmarked against total patenting activity (all technology sectors) in a given country. For instance, India features among the top five countries for solar photovoltaic (PV), while Brazil and Mexico share the top two positions in hydro/marine (UNEP, EPO, and ICTSD 2010).

### 2.3.3. Trade flows in CETs are dominated by a select group of countries

The original group of 14 countries that initiated negotiations on the plurilateral Environmental Goods Agreement make up a significant portion of trade in a number of CETs, including solar PV panels and wind turbines (see Box 1). In wind turbines, non-EGA members such as India are also prominent exporters.

### Box 1: G14 Trade in CET Products

The G14<sup>6</sup> account for an overwhelming portion of trade in the core CET products—wind turbines and solar PV equipment—in particular in terms of exports. In the period 2011-13, the G14 accounted on average for 96% of the value of world exports (excluding intra-EU28 trade) in wind-powered generating sets (Harmonized System (HS) 850231), although its share in total world trade (exports plus imports) was less than 70% (because of a smaller share in global imports). Similarly, the G14 portion of world trade (excluding intra-EU28 trade) in HS 854140 (which includes solar PV cells, modules, and panels) was about 90% (its share in world imports fell from 91.5% in 2011 to 84% in 2013). Between 2011 and 2013, the value of G14 exports in HS 854140 to other G14 countries (excluding intra-EU28 trade) fell by more than one third, while the value of G14 exports to non-G14 countries increased by approximately 15%. PV-specific national trade statistics (using the ITC Trade Map) reveal that the portion of Chinese exports of PV cells, in value terms, shipped to other G14 markets fell from 94% in 2011 to 79% in 2013 as the combined result of a more than 60% reduction of exports to G14 markets (in particular the EU and the US) and an almost 70% increase in exports to non-G14 countries (from a relatively low base).

Source: Vossenaar (2014)

<sup>6</sup> The original G14 is composed of Australia; Canada; China; Costa Rica; the European Union (and its 28 member states); Hong Kong, China; Japan; Korea; New Zealand; Norway; Singapore; Switzerland; Chinese Taipei; and the United States.

At the same time, growth in trade has been accompanied by a rise in the use of trade remedies (both AD and countervailing duties—CVDs) against what is perceived as unfair “dumping” or “subsidization.” China is emerging as the primary target and the measures are primarily being

used by the US and EU. Other countries such as Australia, India, China, and Peru have also pursued renewable energy investigations. Targeted countries include Argentina, Canada, China, EU, Indonesia, Korea, Malaysia, Singapore, Taiwan, the US, and Vietnam (see Table 1).

**Table 1: Trade Remedies on Clean Energy**

Product	Country	Trade Remedy	Initiation of Investigation	Year Since Trade Remedy Measures are in Force
EU				
Biodiesel	US	<b>AD + AS</b>	2008	2009
Biodiesel	Canada	<b>AD + AS</b>	2010	2011
Biodiesel	Singapore	<del>AD + AS</del>	2010	-
Biodiesel	Argentina	<b>AD + AS</b>	2012	2013
Biodiesel	Indonesia	<b>AD + AS</b>	2012	2013
Bioethanol	US	<b>AD + AS</b>	2011	2013
Glass Fibres	China	<b>AD</b>	2009	2010
Solar Panels	China	<del>AD + AS</del>	2012	Resolved through price undertaking agreement in 2013. Non-participating producers/exporters in agreement still facing duties.
Solar Glass	China	<b>AD + AS</b>	2013	2013
Peru				
Biodiesel	US	AD	2009	
Australia				
Biodiesel	US	<b>AD + AS</b>	2010	2010
Wind Towers	China and Korea	<b>AD</b>	2013	2014
Solar Modules/Panels	China	AD	2014	
US				
Wind Towers	China	<b>AD + AS</b>	2011	2012
Wind Towers	Vietnam	<b>AD + AS</b>	2011	2012
Solar Panels	China	<del>AD+AS</del>	2011	2012
Solar Panels	China and Chinese Taipei	<b>AD</b>	2014	2014
Solar Panels	China	<b>AS</b>	2014	2014
Canada				
Solar PV modules and laminates	China	<b>AD + AS</b>	2014	[2015]
China				
Polysilicon	US	AD + AS	2012	2013
Polysilicon	EU	AD + AS	2012	2014
Polysilicon	South Korea	AD + AS	2012	2013
India				
Solar Cells/Modules	China	<del>AD</del>	2012	-
Solar Cells/Modules	US	<del>AD</del>	2012	-
Solar Cells/Modules	Malaysia	<del>AD</del>	2012	-
Solar Cells/Modules	Chinese Taipei	<del>AD</del>	2012	-

Note: Trade remedies in force are highlighted in bold. Investigations that have been terminated are crossed out. The remaining trade remedies are under investigation, but might come into force. The use of [...] means that the formal decision is not taken. The absence of brackets around a year means a final decision has been taken and duties continue to be applied.

Source: The table builds on Table 1 in Kasteng (2013) and has been updated by the author as of July 2015.

It is estimated that over the period 2008–12, trade remedies affected US\$32 billion worth of trade in green products, thus causing an annual reduction in trade of about US\$14 billion and a trade loss of US\$68 billion over a five year period (the duration of trade remedies is five years) (see Table 2). According to a global survey of trade remedies in the CET sector from 2008 through early 2014 carried out by the Peterson Institute for International Economics (Cimino and Hufbauer 2014), there were 41 cases of trade remedies, which included 26 AD cases and 15 parallel subsidy investigations. Of these, 18 cases targeted solar energy products, 16 targeted biofuels, and seven cases targeted wind energy products.

A number of factors have sparked the use of trade remedy measures. These include: supply-demand imbalances; commoditization and falling prices of solar PV; the rise of China as a manufacturing and export hub in solar and wind equipment; as well as special AD and CVD duties extending to China as it is considered a “non-market” economy. While a number of clauses applying non-market status to China’s economy are set to expire in 2016, it is being debated whether this implies the automatic exemption of China or whether it would fall within the discretion of the importing country (Parnell 2015).

The number of active trade remedy cases being pursued within the WTO Dispute Settlement Understanding (DSU) is significantly less although it still exceeds 10 since 2010. The EU anti-dumping measure on biodiesel from Argentina is one such clean energy related trade remedy dispute that has seen a WTO panel being established on 23 June 2014.<sup>7</sup>

The WTO has also seen disputes on local content measures whose use in the CET sector appears to be rising despite WTO rules explicitly prohibiting their use as well as related subsidies. A complaint by Japan and the EU against the LCR in Ontario’s feed-in tariff programme led the WTO’s Dispute Settlement Body to rule against Canada (ICTSD 2013). Ontario consequently reduced its domestic content requirements for future contracts and eliminated them in December 2013. The savings to Canadian ratepayers from this elimination has been estimated at Canadian \$1.9 billion over 35 years.

India has also faced two challenges from the US on its LCRs for solar PV cells and modules under its Nehru Solar Mission. The first challenge, which did not proceed beyond consultation, was related to the first phase of the Mission under which developers of PV projects using crystalline silicon technology had to source their solar cells and modules domestically. Under the second phase, launched in October 2013, this requirement was also extended to thin-films, an important US export to India, which fell after the measure was introduced even though analysts argued that most Indian solar PV capacity development was driven by state requirements which did not include LCRs. Further, of the total 9,000 megawatts being commissioned under Phase II between now and 2017, only half—in the first batch of projects, 375 megawatts out of 750—will be subject to the domestic sourcing requirements. Still, the US contended that the measures were inconsistent with India’s obligations under Article III of GATT and Article 2.1 of the Agreement on Trade-Related Investment Measures (TRIMs), also stating that solar power developers who maintain the

**Table 2: Comparative Statistics of Countries that Impose Anti-Dumping and Countervailing Measures Targeting Renewable Energy Products**

Country	GDP, 2012 (US\$ billions, current prices)	Renewable electricity net generation, 2012 (TWh) <sup>b</sup>	AD cases		CVD cases		Total imports affected for 41 AD/CVD cases in renewables (US\$ millions)
			Number of cases in renewable energy since 2008	Number of total cases (2008-2012) <sup>a</sup>	Number of cases in renewable energy since 2008	Number of total cases (2008-2012) <sup>a</sup>	
Australia	1,532	29.0	3	49	1	7	456
China	8,227	797.4	3	53	2	6	2,144
European Union	16,687	684.1	10	75	8	21	24,408
India	1,842	162.0	4	167	0	0	502
Peru	204	22.1	1	10	1	7	40
United States	16,245	507.8	5	68	3	44	4,414
<b>Total</b>	n.a.	n.a.	26	422	15	85	31,965

n.a. = not applicable; TWh = terawatt hours; AD = anti-dumping; CVD = countervailing duties

<sup>a</sup> The total number of AD and CVD cases is through year-end 2012, based on Bown (2012a) and (2012b).

<sup>b</sup> Renewable energy sources include biomass, hydro, geothermal, solar, wind, ocean thermal, wave action, and tidal action. Data for China and India from 2011; EU data from 2010; all other data from 2012.

Note: Cases that target multiple countries but concern the same product(s) are counted separately.

Sources: GDP from World Bank, World Development Indicators Database, <http://data.worldbank.org/indicator>; electricity generation from US Energy Information Administration, International Energy Statistics, <http://www.eia.gov/countries/data.cfm#undefined>; AD/CVD cases from tables A1 - A2, Bown (2012a) and Bown (2012b); total imports covered by AD/CVD cases from authors' calculations, see table 3.

Source: Cimino and Hufbauer (2014)

<sup>7</sup> [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds473\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds473_e.htm).

domestic content requirements receive special advantages including long-term tariffs for electricity. The US challenges led to the establishment of a WTO panel in September 2014 (ICTSD 2014). India defended its measures as government procurement, a claim difficult to justify given the WTO ruling in the Canada case.<sup>8</sup> The DSU ruling was made in August 2015, where the panel ruled against India (Kanth et al. 2015). At the time of writing, the panel report has not yet been made public. However, the case also opens up possibilities for designing measures to promote local content by non-signatories to the Agreement on Government Procurement (GPA) that may be compliant with their existing WTO obligations.

The use of trade remedy measures as well as local content measures increases the price of CET equipment, leading to price rises in power generation and a dampening effect on investment. Thus, solar power producers in various countries, for example, have generally opposed the imposition of such measures and requirements; whereas domestic equipment manufacturers that struggle to compete with cheaper imports (whether due to perceived unfair advantages or not) favour them.

On the other hand, many view the clean energy sector as a “new frontier” with opportunities to build a manufacturing base and generate jobs, but which also requires some degree of protection or non-compliance with WTO rules as they exist. What appears clear is that there is a high degree of correlation between the countries that are among the biggest GHG emitters, the biggest traders, the biggest destinations for clean energy investments, and those most involved in trade disputes in the clean energy sector.

The intertwining of very similar actors also implies that from a governance point of view, action by a select number of countries both in the climate sphere and the trade policy sphere could make a big difference to the prospects of renewable energy scale-up.

## 2.4. Why Litigation Does Not Work

One option to address gaps and resolve a lack of clarity is through litigation. However, the purpose of litigation in the WTO context is “to preserve the rights and obligations of Members under the covered agreements” (DSU Article 3.2) rather than to attempt to change the rules. Porges and Brewer (2013), referring to Van Grastek (2013) and others, claim that the cost and delay involved in achieving change through negotiation lead members to try to make new rules through litigation. But litigation does not offer clarity and long-term predictability to the market, as WTO rulings are specific to each case. Therefore, while they may provide a general indication of the broad direction in which policy measures need to go, they cannot be a precedent. Litigation also involves time delays and may not respond flexibly to the needs of a dynamic and fast-evolving CET market and investment landscape. Consequently, it may not form a solid foundation of governance that would enable CETs to be massively scaled up in response to the urgent imperative of climate change mitigation. In the event of slow momentum in negotiations as well as the drawbacks of litigation, the interpretation of rules through WTO committees or negotiations carried out through *ad hoc* or sectoral processes could emerge as a more realistic option for reform. Members of the Expert Group have therefore argued that litigation is not necessarily a preferred route forward, in particular as the rules that the panels interpret in litigation were drafted long before climate change was on the agenda. Rather, many of the options explored in this paper are motivated by the wish to refrain from unnecessarily relying on the WTO’s dispute settlement mechanism to define the limits on how climate action is allowed to interfere with trade.

<sup>8</sup> Presentation by Amelia Porges at the E15 Expert Group Meeting on 2 July 2014.

# 3. Trade Policy Options to Support Clean Energy Scale-Up

## 3.1. Options for Addressing Systemic Issues

The WTO agreements, particularly the General Agreement on Tariffs and Trade (GATT), were drafted long before climate change was high on the agenda of policy-making. Hence, there is no specific mention of the challenge in the texts. Any policies and measures implemented for climate change reasons, with possible trade implications, therefore have to be justified largely on the general exception clause of the GATT, Article XX, and in particular its provisions (b) and (g). These read:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(b) necessary to protect human, animal or plant life or health.

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

In addition, the general exception of the GATS (Article XIV) provides a similar right of adoption of measures affecting trade in services in order to protect human, animal or plant life or health.

The E15 Expert Group has studied several options for enhancing policy space for renewable energy and climate policies in the context of the WTO framework. The most ambitious of these measures would consist of amending the GATT, so as to ensure that policies supporting the development and scale-up of clean energy for climate change mitigation purposes would be more explicitly permissible and thus sheltered from challenge. The amendment rules appear in Article X of the WTO's constitution, the Marrakesh agreement establishing the

WTO. Bringing climate-related considerations into the GATT as well as the GATS and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) would automatically cover any trade-related measure, as specific agreements such as the Agreement on Agriculture or the ASCM are an extension of the GATT continuum.<sup>9</sup>

An amendment would require consensus regarding the need for reform, and subsequently regarding the text. If members manage to overcome this hurdle and a text is negotiated, at least two thirds of the membership would need to give a positive acceptance, a process that would likely take several years. Once the amendment would enter into force, it would only bind the members that have accepted it, meaning that the system could end up with two sets of parallel rules.

An amendment of the GATT, meaning that members' concerns will have been resolved by negotiation and agreement, would indeed give the ultimate decision a level of legitimacy that is not present in any rule change brought about through litigation (Porges and Brewer 2013). However, members of the Expert Group have argued that such a solution would be unlikely, as it would seem very difficult to reach consensus on the need for an amendment, in addition to the transaction time to consent on the subsequent text. More importantly, such an amendment would not necessarily provide legal security for climate change measures, as there is a risk that the system would operate based on two sets of rules. As stated by Porges and Brewer, "any member that cares more about its exports than about climate change can decide not to accept the amendment, free ride on the climate change mitigation measures by others, and retain the ability to bring a WTO dispute against the climate change mitigation measures."

A waiver could possibly bridge over the period before an amendment enters into force, and eliminate the free rider problem. Waivers are governed by Article IX:3 and IX:4 of the Marrakesh Agreement. Waivers are temporary and have the effect of legally waiving the application of a stated WTO obligation.

<sup>9</sup> The ASCM for instance is an interpretation/elaboration of GATT, Article XVI.

If WTO members wish to authorize discriminatory measures based on climate change concerns, they can do so by agreeing on an amendment package coupled with a waiver that expires for each member when the amendment has entered into force for that member. However, the unavoidable political problems of obtaining a waiver, similarly to an amendment, remain; members wanting an amendment and a waiver will need to make the environmental, economic, factual, and political case for the specific measures they want to take, and persuade other members to go along. They would also need to actively engage with the concerns of other members regarding the trade impact of the measures that the waiver could cover.

Another option could be an interpretative understanding, as provided for under Article IX:2 of the Marrakesh Agreement. Such multilateral interpretations are meant to clarify the meaning of existing obligations, rather than to modify their content. A decision to adopt an interpretative understanding must be taken by a three-quarter majority of all members. Any proposal for an understanding must first be recommended by the council overseeing the relevant agreement decision, which requires consensus. The legal status of an understanding is that it shall be “taken into account” when interpreting a treaty.<sup>10</sup> Although challenging to achieve, there are a few examples of successful interpretative understandings, which have also had an impact in disputes, such as the *US-Tuna II* referring to a decision by the Technical Barriers to Trade (TBT) Committee (Porges and Brewer 2013).

An option that would not require the same degree of consensus would be a plurilateral agreement between a subgroup of countries regarding how they will interpret WTO rules in trade relations with each other. The impact of such an agreement would depend both on the scope of the agreement and on whether its parties include major players in the WTO.

Under a plurilateral agreement, members would in any case be bound by the non-discrimination rules of the WTO. Yet member countries would be free to agree to more restrictive rules than under the WTO—for example, they could strengthen the disciplines on anti-dumping. However, if they were to agree to a more flexible interpretation of rules, in the area of subsidies for instance, they would still be subject to possible challenges by any non-participant that is a WTO member.

A plurilateral agreement of this sort stands apart from the WTO and cannot be blocked by one WTO member, unlike the options discussed above. However, unless added to Annex 4 of the Marrakesh Agreement, the agreement has no stable legal relationship with the WTO. Adding the plurilateral to Annex 4 would require consensus. In light of the recent developments in Geneva, where a group of countries have agreed to negotiate the EGA plurilateral agreement on a most-favoured-nation (MFN) applicability basis, this option may be timely and appealing.

A number of experts have also advocated the idea of plurilaterals outside the trade system, under the form of “climate clubs” involving major GHG emitting countries. According to Leycegui and Ramírez (2015), such clubs would provide trade incentives for participating members conditional on the attainment of a minimum standard of “contribution” towards climate goals while not increasing trade restrictiveness towards non-club WTO members. The authors consider a general and permanent exception to the MFN clause allowing such “clubs” to be a simpler pathway to pursue urgent climate goals as compared to the difficulty of amending several WTO provisions.<sup>11</sup>

Given the risks and unpredictability of litigation as a strategy highlighted earlier, one additional option could be to agree to a moratorium on dispute settlement in the area of clean energy. Precedents exist in intellectual property, under Article 63 of the TRIPS Agreement, and in Agriculture, under the Peace Clause in Article 13 of the Agreement on Agriculture. Porges and Brewer (2013) suggest that the WTO could adopt a similar dispute settlement concerning some or all climate change mitigation measures. In that case, members would have to make the case for the urgency of action to mitigate climate change, the necessity of the actions they contemplate, and justify why actions cannot be undertaken in a WTO-compliant manner. Members would also have to engage with and resolve the concerns of other members regarding the trade impact of the proposed climate measures.

By choosing this option, the rules would remain unchanged; it would simply be tolerated that WTO members, for specific climate change purposes, would sometimes need to be in breach of the rules. Whereas this may be a more feasible way forward than the amendment option, for example, it would seem less attractive from a coherence perspective: if members recognize that certain measures may be necessary for climate change purposes, should it then not be possible to make these WTO-compatible?

Some group members have argued during the E15 deliberations that it may be more desirable to seek a universal response cutting across sectors, or make smaller adjustments, rather than carve out CETs as a special sector. The merits of more regulation as against enabling greater global competition will also need to be weighed up.

### 3.2. Options for Reform or New Rules

This section covers policy options with regard to specific trade reforms and the need for new rules as proposed by members of the Expert Group. These have been categorized on the basis of two broad objectives: (i) strengthening markets; and (ii) responding to the need for any additional policy space that may be required to pursue climate change mitigation and other sustainable development goals through the scale-up of clean energies.

<sup>10</sup> Vienna convention on the Law of Treaties (1969), Article 31.(3)(a).

<sup>11</sup> According to Leycegui and Ramírez, this would be similar to Article XXIV of the GATT permitting regional trade agreements based on certain conditions, or the Enabling Clause that forms the basis of special and differential treatment enjoyed by developing countries with respect to a number of provisions.

### 3.2.1. Strengthening markets

Trade reform can take the shape of market access liberalization involving the removal of import tariffs and non-tariff measures for CETs, as well as the scheduling of new market access commitments for clean energy services. In addition, markets can be strengthened through a better classification of clean energy services while also addressing regulatory issues such as domestic regulation of services and the governance of private standards. The need to avoid “technological lock-in” is important and initiatives should encourage the adoption and dissemination of new technologies as they evolve.

#### i. Tariff liberalization under different scenarios: Doha Development Agenda, EGA, regional trade agreements, a Sustainable Energy Trade Agreement (SETA), and unilateral action

Reducing or eliminating tariffs is highly relevant in a world of fragmented production and value chains across jurisdictions, regardless of how low tariff levels may appear. As inputs and intermediate goods cross borders multiple times, tariff costs can aggregate to very meaningful amounts before goods reach final assembly. Such costs have a major bearing on the choice of competitive sourcing options for diverse final markets. Tariff liberalization on clean energy goods is a tangible, fairly simple measure that countries could undertake to facilitate a scale-up of CETs. Whereas the mandate on environmental goods in the Doha Development Agenda (DDA) would allow for progress in this area, multilateral negotiation has to date been largely unsuccessful. Consequently, this subsection focuses on options to make progress in effective plurilateral settings.

##### *An option within reach: the EGA plurilateral initiative*

In January 2014, as indicated above, a group of thirteen WTO custom territories plus the European Union announced their commitment to “achieve global free trade in environmental goods” and hence their intention to negotiate a relevant trade agreement, now called the EGA.<sup>12</sup> This agreement builds on APEC’s Early Voluntary Sectoral Liberalization initiative and specifically APEC’s 2012 agreement to reduce applied tariffs on a list of 54 environmental goods to a maximum of 5% by end-2015. The intent of the original 14 EGA members is to extend the benefits accruing from the initiative on an MFN basis to all other WTO members—i.e. on a non-discriminatory basis to signatories and non-signatories alike.<sup>13</sup>

The EGA countries include a majority of the main trading economies in many relevant environmental goods. The agreement will only be finalized as WTO-compatible

once a critical mass threshold is reached. In the WTO context, “critical mass” is self-defined, meaning that market participation would indicate the necessary number of exporters and importers to minimize free riding such that any outsider economy will be too small to undermine the resulting agreement. Observers of the EGA have speculated that this threshold could be 90% of global markets, following the model set by the WTO Information Technology Agreement, an existent plurilateral tariff cutting arrangement.<sup>14</sup> Critical mass can only properly be calculated once the final list of goods has been agreed. ICTSD preliminary calculations show that in 2012 the 14 EGA countries accounted for 86% of global trade (79% in imports and 93% in exports). Excluding intra-EU28 trade as well as re-imports and re-exports, the share was 83% (Vossenaar 2014).

The EGA is an excellent candidate for making progress in the area of CETs and trade. For the agreement to be significant, it is crucial that all relevant goods are included. The Joint Statement in Davos refers to environmental goods, and highlights clean energy. ICTSD analysis of the APEC list—the baseline list for the EGA negotiations—shows that some 15 out of the 54 goods are relevant for the supply of renewable energy (Vossenaar 2013). For the ensuing agreement to become truly relevant for climate mitigation purposes, it would seem necessary to significantly increase the coverage of goods. In particular, components now left out of the APEC list, such as inverters used in solar PV systems and ball and needle bearings used in wind turbines, should be included.

Aware of the difficult and so far inconclusive Doha negotiations in seeking to determine what constitutes an environmental good, the EGA negotiations have moved beyond this top-down approach and are proceeding on the basis of lists of goods submitted by parties.

##### *A more ambitious plurilateral approach: a SETA*

Whereas the EGA is now within reach, it has a broader focus than CETs, covering a range of other environmental technologies like waste and water treatment and air pollution. Another plurilateral approach that would more directly target CETs could be a Sustainable Energy Trade Agreement, as proposed by ICTSD (2011). Such an agreement could take the form of a plurilateral agreement negotiated inside or outside the WTO, with the benefits either extended to the full WTO membership adopting the MFN approach, or following the more exclusive GPA approach, meaning that tariff concessions would apply only to SETA members. For the tariff reduction element, the outcome could be similar to the EGA, in particular if the MFN approach were adopted. However, SETA is

<sup>12</sup> See the Joint Statement Regarding Trade in Environmental Goods, issued at Davos, available at [http://trade.ec.europa.eu/doclib/docs/2014/january/tradoc\\_152095.pdf](http://trade.ec.europa.eu/doclib/docs/2014/january/tradoc_152095.pdf).

<sup>13</sup> The number of signatories has since risen to 17 with newcomers Iceland, Israel, and Turkey joining the agreement, which actually represents 44 parties when all EU states are factored (see Box 1).

<sup>14</sup> Other critical mass agreements negotiated under the WTO include telecommunications and financial services, with the former including a rules aspect in addition to market access commitments.

envisioned as a more comprehensive agreement than the EGA, addressing a vast range of policies and other trade barriers beyond tariffs, such as services restrictions and non-tariff measures. The final outcome of a SETA for the scale-up of CET would therefore be more significant than the EGA. It would, however, most likely be more challenging to negotiate.

#### *Benefits of a multilateral setting*

As there is now an initiative to negotiate environmental goods, including clean energy goods, in a plurilateral setting driven by the countries that have been leading the Environmental Goods and Services (EGS) negotiations, it seems unrealistic to expect progress in the area under the Doha Round negotiations. Therefore, the preferred option would be to build on the EGA and to make it as effective, comprehensive, and inclusive as possible.

Sticking for the moment to tariffs, it is important to bear in mind that the main gains from tariff liberalization accrue to those undertaking their own tariff reform. Therefore, it would be central for countries currently outside of the EGA negotiations to join the agreement, or to match the tariff concessions domestically. Not only would this create opportunities for enhanced trade and growth, but it would also increase the opportunities for technology transfer, so that CETs become increasingly available also in non-EGA countries.

The rationale for treating CET goods differently to other goods in a trade context is found in the climate change imperative; hence the importance of expanding the mitigation opportunities related to clean energy globally. This is especially true as many developing economies, currently largely outside the EGA, are expected to see their energy demand grow significantly over the next decades. At the same time, they are committed under the UNFCCC's Paris Agreement to increasingly contribute to mitigation action, and have voluntarily registered under their pledges, the so-called Intended Nationally Determined Contributions, plans to substantially scale-up CETs. It is thus important that their shift to a cleaner energy mix is facilitated through all possible means, including through trade policy.

The question thus arises as to whether these countries would easily join an initiative where the list of goods has already been defined and agreed. Would they be prepared to leave aside previously expressed concerns about the inclusion of dual-use goods, or the possible exclusion of energy-related goods of importance to them such as biofuels? Or, would there be a need for an innovative mechanism that would facilitate entry for non-signatories over time? Some developing country concerns, for instance sensitivity regarding impacts on domestic industries or the need for policy space to develop their own green industries, may require some form of special and differentiated treatment to accommodate such concerns. This is an area that will require further analysis.

#### *Lessons/options from regional trade agreements (RTAs)<sup>15</sup>*

Several aspects regarding CETs and trade governance are being innovated within RTAs. Increasingly, such schemes are evolving from models of “shallow integration” based on liberalizing trade in goods towards “deeper integration,” involving both horizontal expansion (agreements that cover services, trade facilitation and customs, investment, competition, environmental policy) and vertical expansion (commitments on regulatory cooperation and coherence). While a number of RTAs include a set of “General Exceptions” based on Article XX of the GATT, others such as the EU-Korea Free Trade Agreement (FTA) provide a specific exception to their trade facilitation agreement for “legitimate policy objectives such as the protection of national security, health and the environment” (Art. 6.1(g)).

The EU-Singapore FTA is particularly noteworthy in that it contains a chapter on sustainable energy and provisions unprecedented in other trade agreements. For instance, the agreement includes an Article (12.7) on Prohibited Subsidies, and another that establishes a “best endeavours” obligation to remedy or remove competition effects caused by Other Subsidies (similar to the ASCM's concept of actionable subsidies). An accompanying Annex (12-A) lists subsidies that may be provided. These include subsidies for environmental purposes, provided: the subsidy is necessary to achieve the policy objective; the amount provided is the minimum required to achieve that objective; and the aid “does not affect the conditions of trade of either Party or the conditions of competition between the Parties.” An interesting aspect is that the parties record in the agreement that they share the goal of reducing subsidies to fossil fuels (Article 13.11.3) but the Article on Prohibited Subsidies specifically excludes subsidies to the coal industry.

In Article 275 of the EU-Peru-Colombia FTA, the parties agree to “promote and facilitate access, dissemination and use of best available technologies for clean energy production and use and for mitigation of and adaptation to climate change.” The recently concluded Trans-Pacific Partnership (TPP) includes commitments by all parties to eliminate tariffs on environmental goods upon entry into force of the agreement, and to facilitate trade in environmental services. Under the Environment chapter, the parties will also work together to address non-tariff barriers (NTBs) on these products and services to further promote trade in environmental goods and services.<sup>16</sup>

Certain agreements, such as those of the US with Korea, Colombia, and Panama, contain more ambitious commitments regarding implementation of multilateral environmental agreements (MEAs), essentially using trade policy to enforce MEA commitments. The TPP picks up this approach and, for the moment, applies it to conventions related to trade in endangered species, marine pollution, and the Montreal Protocol on substances that deplete the ozone layer, implementation of the latter bringing about climate mitigation benefits.

<sup>15</sup> This section is drawn from Gehring et al. (2013).

<sup>16</sup> TPP Chapter 20, Environment, available at <https://ustr.gov/sites/default/files/TPP-Final-Text-Environment.pdf>.

Trade mechanisms have also been used in RTAs to enforce environmental cooperation objectives. For instance, according to Article 13.6 of the EU-Korea agreement, parties “strive to facilitate trade” in environmental goods and services, including tariffs and NTBs. The EU-Colombia-Peru and EU-Central America RTAs “agree to consider” areas in which removal of barriers and obstacles to trade would support sustainable development and climate change mitigation efforts. Others, such as the majority of Canada’s FTAs, provide for very broad tariff liberalization that includes most frequently referenced environmental goods (e.g. the APEC list). The US Trade Act of 2002 establishes market access for US environmental technologies, goods, and services as a priority, and is thus often covered in US trade agreements. The Environment chapter of the TPP also includes commitments by all TPP parties to effectively enforce their environmental laws, and not to waive or derogate from environmental laws in order to attract trade or investment. The Comprehensive Economic and Trade Agreement, between the EU and Canada, includes a binding commitment not to lower environmental standards (Cosbey 2014).

As indicated, NTBs are also being addressed in RTAs. In addition to the reference to NTBs in the TPP Agreement mentioned above, the EU-Singapore FTA sets out specific commitments in Chapter 7 on Non-Tariff Barriers to Trade and Investment in Renewable Energy Generation. It includes: (i) obligations not to impose local content requirements that affect the other party’s products, service suppliers, investors or investments; (ii) obligations to ensure that authorization, certification, and licencing procedures are objective, transparent, and not arbitrary or discriminatory; and (iii) agreement for mutual recognition of compliance testing of almost all goods in HS Chapter 84 (i.e. boilers, machinery, and mechanical appliances like refrigerators) and solar PV panels and wind-powered generators.

In the area of regional integration, the emerging mega-regionals especially provide interesting opportunities for furthering trade in CETs. Indeed, their mere size makes any progress on this issue potentially very important.

The TPP does include a section on the Transition to a Low Emissions and Resilient Economy. In support of this transition to a low emissions economy, it recognizes the need for collective action, and agrees to mutual cooperation and support in transitioning to a low emissions economy. It also makes explicit reference to cooperation on matters of joint or common interest with respect to energy efficiency; development of cost-effective, low emissions technologies and alternative, clean and renewable energy sources; sustainable transport and sustainable urban infrastructure development, among others. However, the nature of cooperation is not specified, making the provision rather soft.

The Transatlantic Trade and Investment Partnership (TTIP), between the US and the EU, is also a particularly interesting mega-regional as it would theoretically be able to set the bar high and make progress on behind the border issues. Indeed, tariffs between the two are typically already low, which is why the focus is on regulatory cooperation and on addressing NTBs. The negotiations, however, are heavily criticized by environmental groups on both sides of the Atlantic (see for example Ackerman 2015). It would be important that their concerns are addressed, and that the agreement contribute to raising environmental standards and take concrete action, not the least in relation to climate change and clean energy.

## ii. Services: GATS scheduling, classification, DDA, Trade in Services Agreement, and RTAs

Trade in services plays a critical role in the deployment of clean energy and comprises a major input into clean energy projects. It is therefore crucial to address clean energy services in a trade context. After more than a decade of services negotiations under the GATS, little progress has been made in the area and there is a need for targeted efforts.

One interesting development has been the launch of negotiations on a Trade in Services Agreement (TiSA) by a group of like-minded countries.<sup>17</sup> As in the case of the EGA described in the subsection on tariffs, TiSA offers a promising venue to achieve progress in the area of clean energy using a plurilateral approach, which could later benefit the full WTO membership.

One of the challenges in clean energy services (or services in general for that matter) is the lack of an appropriate, universally agreed classification (Sugathan 2013). Environmental services follow the fairly old W/120 classification list based on the United Nation’s Central Product Classification, and may not adequately capture a number of clean energy services, particularly in critical areas such as design and installation, construction and maintenance. However, the absence of an appropriate classification should not prevent countries from reforming the clean energy services sector. Rather, countries should take action to address this gap.

As a first step, a scoping exercise that helps countries better understand the coverage of products and activities that may be relevant for the supply of CETs would be a prerequisite for eventually negotiating commitments (Bernabe 2013). Such an exercise could take place in the Council for Trade in Services under the WTO, if this would be opportune given the current state of the DDA. Alternatively, the exercise could evolve within TiSA and take the form of a negotiating proposal by a country or a group of countries. This could then lead to a document that would set out all

<sup>17</sup> At the time of writing, these countries are Australia, Canada, Chinese Taipei, Chile, Colombia, Costa Rica, Hong Kong China, the EU, Iceland, Israel, Japan, Mexico, New Zealand, Norway, Pakistan, Peru, Singapore, South Korea, Switzerland, Turkey, and the US.

the different activities or services subsectors relevant to clean energy, which will aid in the development and optimal usage of clean energy through their liberalization. In this exercise, countries could turn for inspiration and guidance to existing sectoral approaches under the GATS—such as the GATS Annexes on Air Transport, Financial Services, and Telecommunications, as well as the Understanding on commitments in Financial Services.

A next step would then be to engage in actual trade reform (ibid). If a critical mass of countries would be prepared to engage and make commitments, it would make sense to try and negotiate an agreement incorporating definitions and descriptions as identified in the scoping exercise. If only a smaller group of countries opt to make commitments, it may make more sense to incorporate the definitions as laid out in their individual schedules of commitments.

Much of the above could take place in a plurilateral setting. The benefit is that it may enable a more expeditious process, with potentially greater coverage than would be possible under a multilateral process, which would involve more trade-offs and compromises. Given the more flexible approach to services negotiations traditionally (as compared to goods negotiations) it would still be possible for new entrants in a future agreement to make appropriate commitments relative to their respective domestic conditions. Having said that, it would also imply a bigger risk that new entrants miss out on the opportunities linked with domestic reform than in the case of goods. This could be compensated for to some extent by new members undertaking autonomous liberalization efforts that spur reform, even if they are not immediately scheduled as binding commitments.

In this context, if countries choose to pursue a plurilateral approach to trade in clean energy services, initially outside the WTO, for instance through a SETA-type approach, one recommendation would be to liaise closely with the EGA negotiations on tariffs. Indeed, clean energy goods and services are often provided in an integrated manner, and a minimum level of coordination would result in a more coherent outcome. Even better would be to fully integrate services negotiations as part of the EGA, thereby turning it into a green technologies agreement. A proposal on the fusion of goods and services negotiations for technologies where this may be required has been explored in the E15 Expert Group on Services.<sup>18</sup> Currently, a few parties to the EGA have indicated that they wish to address services in that agreement. In this scenario, there will need to be even stronger coordination with TISA, as the latter could involve negotiations on several services such as construction and engineering that will also be relevant to clean energy delivery.

### iii. Regulatory issues; NTBs: TBTs, harmonization, private standards, regulatory convergence, domestic regulation of services; access to infrastructure and networks

In addition to the multiple avenues of possible progress undertaken unilaterally, plurilaterally, or regionally, there are still reforms that would need to take place under the WTO (Bernabe 2013). One example is the area of non-tariff measures in clean energy, particularly standards and conformity assessment measures, and the extent to which these may unfairly restrict trade or be more burdensome than necessary. Another area is the lack of clarity in WTO rules regarding the extent to which private sector standards can be disciplined under the TBT Agreement (which would be relevant for clean energy technologies).

Yet another example concerns domestic regulation in services. In fact, discriminatory regulatory measures may result in inhibiting not only the supply, transmission, dispatch, and distribution of renewable energy, but also, more relevant in the context of international trade, the foreign service suppliers who are intent on investing in and supplying those services. At the same time, space will need to be provided to address legitimate domestic regulatory concerns of WTO members.

Yulia Selivanova (2015) points out that to meet climate change targets, large amounts of clean energy will need to be able to connect to networks, including for the purpose of cross-border trade in clean energy. Indeed, a number of countries will find that their natural conditions make it impossible to source clean energy from within their territory, and importing electricity may be needed to shift their energy mix away from fossil fuels. Long-term investments in energy infrastructure will therefore be necessary.<sup>19</sup> Moreover, regulation of access on reasonable terms to transport and distribution networks will be crucial for the integration of clean energy trade into an economy. While the multilateral trade rules are oriented towards ensuring market access, additional measures are needed to guarantee availability of fixed infrastructure and timely access to transportation pipelines/networks, distribution systems, etc. The issues and proposals discussed below with respect to clean energy access to infrastructure and networks, and the implications for WTO reform, particularly GATS rules, are derived from Selivanova (2015).

One of the challenges with regulation of third party access to transportation networks in a trade governance context is related to the fact that such infrastructure is mostly controlled by private companies rather than by governments, the subjects of obligations under

<sup>18</sup> See the policy option paper in the present series produced by the E15 Expert Group on Services, entitled Rethinking Services in a Changing World. Option 10 addresses the issue of compatibility between rules governing goods and services and calls for the establishment of a Working Group (or another mechanism) open to all WTO members, which could consider, among others, the possibility of including both goods and services in some stand-alone agreements such as one dealing with environmental products.

<sup>19</sup> There is already interest in and serious discussions on developing an interconnected global grid for clean energy. See for example Chatzivasileadis, Ernst, and Andersson (2013).

WTO agreements. Existing rules do not address the anticompetitive practices commonly carried out by incumbents controlling different segments upstream and downstream of the energy value chain. To address this, additional pro-competitive disciplines would be necessary. Selivanova argues, however, that it would be inefficient and unreasoned to negotiate pro-competitive disciplines for clean energy networks alone. A better option would be general rules linked to the GATS, with possible specific provisions covering preferential access for clean energy to networks.

Additional commitments, either in an annex to the GATS on Energy Services or a reference paper, could be used to address competition issues and third party access to fixed infrastructure, similarly to the additional disciplines for the telecommunications sector. The following issues need to be tackled to secure an effective pro-competitive framework for clean energy trade, including third party access to fixed infrastructure:

- Ensuring third party access to and interconnection with energy networks and grids, as well as other essential infrastructure whether dominated by government entities or privately-owned companies;
- Creating an independent regulator separate from and not accountable to any supplier of energy services;
- Ensuring non-discriminatory, objective, and timely procedures for the transportation and transmission of energy;
- Maintaining appropriate measures for preventing certain anticompetitive practices in the sector;
- Ensuring transparency in the formulation and implementation of rules, regulations, and technical standards;
- Requiring the provision of non-discriminatory and timely information on data relevant for transportation and transmission of energy, such as prices and transmission capacity;
- Ensuring security of supply and non-interruption of energy transportation; and
- Providing expeditious and fast-track dispute settlement (as the interruption of energy transportation services can have drastic consequences on consumers).
- Moreover, it should be envisaged to allow governments to provide preferential grid access to clean energy on a non-discriminatory basis between domestic and foreign suppliers. In addition to general provisions to this effect in an annex or reference paper, this could be achieved through the inscription of corresponding services in the members' schedule with a listing of respective conditions and qualifications.

Furthermore, as regards transit through fixed infrastructure (such as grids), general transit rules are not as complete as they should be to address all pertinent problems faced by cross-border clean energy trade.

It has sometimes been doubted whether Article V of the GATT 1994 applies to energy products and materials at all, especially electricity and transportation methods, notably grids. For the sake of clarity and predictability on the above issues, it could be envisaged to adopt an interpretative note to Article V, clarifying that transit disciplines indeed do cover electricity transit via fixed infrastructure. Similarly, it should be possible to clarify that the obligation for a member state to guarantee freedom of transit applies in any case, regardless who owns the transportation infrastructure.

Should the application of WTO transit rules with respect to energy be revisited (which is desirable), the Energy Charter Treaty transit provisions and the Transit Protocol discussions could be useful to draw lessons from (despite the failure to reach a final agreement on the Transit Protocol). Issues such as setting transit tariffs, congestion management, and the distribution of available capacity are especially pertinent.

Finally, the question of preferential access for “clean” electricity to transport networks should be addressed. Legislation in some countries already gives priority grid access to renewable energy, although, until present, such clean energy has typically been produced domestically. In the case where the capacity of networks is limited, and transit becomes *de facto* impossible because of preferential access granted by the national legislator to domestically produced renewable energy, the implications of current rules are not clear. For the purpose of promoting clean energy, the rules should explicitly allow priority access to the networks, be it exported, imported, or domestically produced and consumed.

Another option would be to address the issues related to energy trade through fixed infrastructure in a separate agreement devoted to energy trade under the auspices of the WTO, including in a plurilateral setting, such as the proposed SETA (ICTSD 2011). Apart from the question of feasibility of such an agreement, it could be argued that the disciplines covering energy trade via fixed infrastructure should be created for energy in general, not only clean energy. However, according to Selivanova (2015), clean energy trade would be the main beneficiary of such rules, especially if the possibility of preferential access for clean energy to the networks could be introduced.

Considering the lack of extra large capacity in energy infrastructure, third party access rules will not necessarily be sufficient to address the problem. Therefore, a more difficult issue is linked to the creation of new infrastructure. For the development of regional and global energy trade, it would be important to devise rules that mandate new infrastructure construction, especially if an investor offers to undertake this construction. Rules for the expansion of network capacities and the construction of new infrastructure are necessary for the development of clean energy trade and investment. The WTO framework does not contain investment disciplines; yet such disciplines appear necessary to effectively advance the construction of fixed infrastructure required for clean energy trade (*ibid*).

### 3.2.2. Policy space beyond tariffs

Non-tariff measures constitute important barriers to trade in many cases, and particularly in the realm of clean energy. The CETs in this paper refer to those required for the provision of electricity where the sector competes with fossil fuels, which continue to benefit from considerable subsidies, granted at the consumer and producer level, in countries at all levels of development across the world. Moreover, the clean energy sector itself receives different kinds of subsidies and assistance, both to compensate for fossil fuel support but even more to bolster the development of a sector that is still young and in need to grow, mature, and eventually become a viable alternative to fossil energy. This support is often delivered as part of a policy package also intended to stimulate local jobs, growth, and income. In addition, energy is often provided through complex public-private supply chains and with a heavy involvement of state-owned enterprises. All in all, this gives rise to intricate business models where it is difficult to distinguish “regular” business from various policy objectives.

Whereas reducing barriers to market access for CETs is crucial for optimizing supply chains, governments often wish to retain a degree of policy space to pursue various goals related to sustainable development. These include not only climate change mitigation but also the generation of green jobs, domestic industrial development, and technology transfer. It has also been argued that in bigger markets the creation of domestic “green industries,” including in the CET sector, will drive down long-term costs of clean energy deployment even if they may impose short-term costs or are uncompetitive relative to CET imports (in the absence of trade barriers). The “unlevel playing field” in which renewables have to compete against often heavily subsidized fossil fuel sectors is also mentioned to justify support to the CET sector.

In all of these discussions, it is important to bear in mind whether the achievement of climate mitigation goals would be constrained or facilitated in any way by the adoption of such policy space, and also if they could be pursued in the most effective manner without sacrificing domestic economic and social policy objectives. Critics of the need for “policy space” often argue that trade restrictions may not be the answer to foster domestic CET industries, nor indeed be the optimal response to any of the other relevant policy objectives. For instance, to generate green jobs, climate mitigation policies may most effectively be served by sourcing technologies and services at the lowest cost in world markets. Moreover, critics also point out that clean energy scale-up also generates jobs in services such as installation, construction, and maintenance that are invariably local. Further, they also argue that WTO rules do not restrict the pursuit of clean energy in any way (even through subsidization) so long as measures do not discriminate between local and foreign-made technologies. However, there is arguably a lack of clarity regarding the extent and type of measures that countries can use for clean energy deployment. In addition, the increasing use of trade remedies in response to the perceived dumping or subsidization of CETs also pits “fairness in trade” against “rapid CET deployment,” which benefits from cheap imports.

The Expert Group proposals outlined below concern three areas related to domestic policy space and associated measures that could benefit from greater clarity and predictability as well as “flexibility” with respect to trade rules. The three areas are subsidies, local content requirements, and trade remedies.

#### iv. Subsidies: options for adjusting the ASCM

The work carried out by the E15 Group has highlighted that the *status quo* is not an option in the area of subsidies and the ASCM. Members argue that there is a need for some sort of reform; on the one hand to ensure that governments have the necessary policy space to support the development of clean energy, and on the other to further discipline the use of support that may be trade distortive, either between countries or between sectors (e.g. fossil fuels and clean energy).

The recent *Canada-Renewable Energy/FIT* case to some extent provided shelter for certain non-discriminatory support policies, but it did not offer full immunity.<sup>20</sup> The creation of this partial safe harbour may have come at the expense of transparency and subsidy governance (Cosbey and Rubini 2013). Unless steps are taken to address this, the WTO will most likely be facing increasing litigation. As stated in section 2 *supra*, members of the Expert Group and think piece authors Cosbey and Rubini as well as Porges and Brewer argue that a case law solution has inherent limitations and express the opinion that this is not the preferred way forward. Cosbey and Rubini (2013) contend that “only reform can ensure the legitimacy of the fundamental decision of what type of government intervention should be permitted and what should not. Only reform can ensure the necessary legal certainty to both government and business action.”

A number of alternatives to litigation exist. These range from the very ambitious, often requiring considerable efforts to achieve, to options that may offer temporary and/or partial solutions, involving a lower level of political compromise.

The most ambitious measure would be an amendment of the ASCM, and/or Article XX of the GATT to ensure that policies supporting the development and scale-up of clean energy for climate change mitigation purposes would be more explicitly permissible and thus sheltered from challenge. This option was discussed earlier under systemic issues. Another option, also described in section 3.1, could therefore be an interpretative understanding. An interpretative understanding could, for example, resolve the ambiguity regarding the question of whether the general exception under Article XX of the GATT applies to the disciplines in the ASCM (Howse 2013). An interpretative understanding could also reinforce the *dicta* suggested in *Brazil-Retreaded Tyres*,<sup>21</sup> suggesting that climate change policies would fall within the provisions (b) and (g) of that article (*ibid*). One advantage of this approach is that it might be able to address the issue of fossil fuel subsidies. Under Article XX (b), a member subsidizing clean energy would

<sup>20</sup> Canada – Certain Measures Affecting Renewable Energy Generation Sector, Canada – Measures relating to the Feed-in Tariff program, WT/DS412/R, WT/DS426/R.

<sup>21</sup> Brazil – Measures Affecting Imports of Retreaded Tyres, WT/DS332/AB/R.

need to justify the necessity of the support. If the member at the same time offers subsidies to the fossil fuel sector, it might be difficult to argue that support to the CET sector is “necessary,” as a less trade restrictive measure exists—i.e. eliminating the support to fossil fuels.

Another approach for an interpretative understanding could be to offer clarification on the concepts of “benefit,” “financial contribution,” and “specificity” in the ASCM (ibid). For example, in the case of specificity, the understanding could define what would be acceptable as “objective criteria or conditions” in the context of clean energy subsidies. Howse (2013) suggests that “this would be based, in the first instance, on recognizing that increasing the use of clean energy relative to energy that contributes to climate change and to other environmental and health problems is a legitimate objective of subsidies policies in this area.” He thereafter suggests that “as an indicative matter illustrative lists might be developed of design features and operational practices that should be presumed to be consistent with the language ‘objective criteria and conditions’ and others that are likely to be problematic (...).”

An interpretative understanding could similarly help clarify whether a feed-in tariff constitutes a “financial contribution.” Howse suggests that this could be done by specifying that clean energy and fossil fuel generated energy are not “like” products or services; that measures that address the relatively higher cost of generating clean energy should therefore be presumed not to provide a financial contribution to clean energy market actors; and that such measures shall be deemed not to provide “price support” within the meaning of Article 1 of the ASCM.

Finally, on the issue of benefit, the interpretative understanding could build on the ruling of the Appellate Body in the *Canada-Renewable Energy* case (see above), and include principles that would state that the determination of benefit requires a comparison against an appropriate market benchmark, which should be different than conventional energy markets. Measures targeted at addressing the cost difference between producing clean energy and conventional energy should be presumed not to confer a benefit.

Another approach is a waiver from the ASCM for existing clean energy policies, similar to the discussion in section 3.1. Howse (2013) proposes that a waiver could apply to policies based on their objectives, meaning that it would apply only to subsidies specifically addressing environmental externalities. It could also be conditioned upon the removal of discriminatory aspects of policies within a set, relatively short time frame. It could further contain an Article XX chapeau-like provision, requiring that policies under the waiver do not constitute arbitrary or unjustifiable discrimination. To benefit from the waiver, a WTO member could be required to eliminate or reform other policies that undermine the objectives on the basis of which the waiver is granted, in particular fossil fuel subsidies.

## v. Local content requirements

Local content requirements are part of the subsidy discussion, and the Expert Group has identified specific options to address them.

Cosbey and Rubini (2013) clearly state that an LCR is not fundamentally an environmental measure, but rather an instrument of industrial policy. Environmental goals can be achieved through LCRs under certain circumstances, but the evidence is thin and suggests that even when that is the case LCRs cannot be considered effective measures. Jha (2013) shows that LCRs raise the costs of clean energy goods for domestic power producers and hinder the immediate and cost-effective generation of clean electricity. Howse (2013) further argues that it may no longer be true that LCRs are necessary to gain political support for incentives and other measures directed at promoting clean energy, as the programmes in question are, in many instances, well established and endorsed by their constituencies.

As LCRs are explicitly aimed at distorting trade and investment flows, they are expressly prohibited under WTO subsidy law. Yet despite weak evidence concerning the environmental benefits of such measures, as well as their incompatibility with WTO rules, LCRs continue to be implemented around the globe. New programmes are even being launched since the WTO Appellate Body ruled against the LCR component of the Ontario feed-in tariff scheme under *Canada-Renewable Energy*.

The question therefore arises whether it is necessary to review existing rules to further clarify the situation. ICTSD research has looked into options for a gradual phasing out of LCRs, possibly limited to developing countries, while at the same time agreeing to an explicit moratorium against any new LCRs. This option would have the benefit of recognizing developing country needs for an adjustment period. It would also avoid further litigation and rally WTO members around an explicit intention to refrain from using LCRs, which might promote better compliance with existing rules. However, this option has generated little support among group members.

An alternative way forward would be to have an interpretative understanding of the ASCM facilitate the conversion of ASCM-inconsistent LCRs into other kinds of WTO-consistent measures which ensure that recipients of clean energy subsidies provide benefits to the local economy. Howse (2013) argues that as a general matter it could be affirmed that conditions such as the training or hiring of local workers, as well as technology transfer, should be presumed to be consistent with GATT, TRIMs, and ASCM rules provided they do not discriminate against imports or violate MFN treatment.

Given the growing use of LCRs despite the prohibition imposed by WTO rules, and particularly in a time of rising foreign direct investment in the CET sector, the issue will need to be addressed on a priority basis.

## vi. Trade remedies

The work carried out in the context of the E15 Expert Group on CETs calls for a reform of the WTO rules governing anti-dumping and anti-subsidy measures to achieve a better alignment with normal competition or antitrust rules (Horlick 2013, Howse, 2013, and Kasteng 2013). This would involve, *inter alia*, the revision of the definition of abuse of a dominant position and of dumping so that the rules specifically target anticompetitive behaviour rather than simple price discrimination, for example, for which there are typically many valid reasons. It would also include addressing some of the more common procedural weaknesses, such as product definition, the identification of indicators of injury, and verification of causality between dumping or subsidization and injury. It would also be desirable to: (i) include a “public interest test,” which would require input from a broader range of stakeholders than is the case today; and (ii) consider the inclusion of environment-specific provisions in the agreements.

Before turning to this long-term agenda, a number of options can be considered in the short to medium term. To begin with, WTO members can simply choose to enforce existing law (Horlick 2013). For example, the current Anti-Dumping Agreement includes provisions that in effect require recognition of “Moore’s law,” which envisages the halving of solar panel costs every 18 months due to learning curves. Dumping calculations must take into account costs spread over the product cycle, as well as the start-up situation of new products and factories.

Other specific options, less ambitious than comprehensive reform as described above, and thus potentially feasible in the short to medium term, include the following (Kasteng 2013):

- Trade remedies on clean energy might be limited in level, by making use of the lesser duty rule;<sup>22</sup>
- Trade remedies might be limited in time;
- Trade remedies might be limited in scope, for example by only permitting measures on a certain number of clean energy products or a certain import value; and
- A criterion on climate change in national public interest tests might be introduced.

Whereas Kasteng refers to these as options for the WTO, it would seem that they could also be applied unilaterally, or within the context of RTAs or a sectoral agreement such as the EGA.

However, research shows that significant trade chilling effects of remedies occur already at the stage of the initiation of an investigation, and that even if the exporter wins the case in the initial phase there is a negative impact on trade (de Lima-Campos and Vito 2004). Therefore, it would be desirable to identify policy options that would prevent cases from even starting (Horlick 2013). This might include options such as a peace clause on trade remedies in the clean energy sector (Lester and Watson 2013). Although theoretically this could be done unilaterally, a more likely scenario would be to reach agreement among a group of like-minded countries, for example in the EGA or in mega-regionals like the TPP and TTIP. In fact, EGA signatories and TPP parties are among the primary users of trade remedies in clean energy. The latter option would therefore go a long way towards addressing the global problem of remedies in the sector. Within the EGA or other trade agreements, it would also be possible to simply eliminate the trade remedy tool—there are several precedents, for example in the New Zealand-Australia FTA or in the European Union (Swedish National Board of Trade 2013).

If the waiver from the ASCM (discussed in section 3.2.2 (iv) above) were implemented, it could include an agreement not to take trade remedy action against any policy covered by the waiver during its period of validity (Howse 2013).

Other more gradualist options could include (ibid):

- An undertaking by willing WTO members to engage in consultations as soon as they are aware that policies and practices in another member may give rise to trade remedy action in their jurisdiction; and
- A commitment to publish an objective study of the costs and benefits of both the measures being responded to by trade remedy action as well as the remedies themselves.
- In a longer-term perspective, WTO members could also consider including a provision of “non-use” of trade remedies in a future WTO agreement on environmental goods, as provided for in the Doha declaration, para 31 (iii).

<sup>22</sup> The lesser duty rule ensures that the trade remedies are not higher than necessary to remove the injury inflicted on the domestic industry.

# 4. Concluding Note

The main policy options presented in this paper are listed in annex in a summary table structured over a short to long-term time horizon. The latter include ambitious proposals for comprehensive reform of the trade system to support the sustained scale-up of CETs, whereas the former offer a gradualist and potentially more feasible approach in the immediate term to respond to the urgent imperative of climate change mitigation and other sustainable development goals.

The historic Paris Agreement reached by delegates to the UNFCCC in December 2015 commits signatory nations to reductions in greenhouse gas emissions with the objective of limiting global warming to “well below” 2 degrees Celsius. The new framework places the burden of action on the implementation by individual nations of respective Nationally Determined Contributions. Most plans for transitioning to a low emissions economy refer to ambitious targets to shift energy matrixes through rapid and massive deployment of clean energy. Effectively implementing the agreement will require increased investment in research and development on CETs, and reaching mitigation targets will in large part depend on the success of CETs. As argued in this paper, an enabling framework of rules as well as targeted trade and investment arrangements can greatly contribute to fostering the necessary scale-up of renewable energy globally.

The policy options paper produced under the E15 Initiative by the Expert Group on Measures to Address Climate Change and the Trade System, available in this series, underlines that “most of the opportunities trade offers in the common struggle against climate change are currently being missed. The effort to address climate change must occur not only within the UNFCCC; it must also occur within the global trade system. There are a whole array of ways the WTO and other trade arrangements can be used affirmatively to maximize trade as a positive force in fighting and forestalling climate change.”

In offering a broad set of options for consideration by policymakers and other stakeholders in developed and developing countries alike, the E15 Expert Group on Clean Energy Technologies has sought to contribute to this effort.

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The papers commissioned for the E15 Expert Group on Clean Energy Technologies and the Trade System can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Short-term options	Medium-term options	Long-term options
<b>Options for addressing systemic issues</b>		
A <b>moratorium on dispute settlement</b> in some or all areas of climate change mitigation based on agreement with trading partners including those whose trade could be impacted by such measures.	A <b>plurilateral agreement</b> between a subgroup of countries regarding how they will interpret WTO rules in trade relations with each other.	An <b>amendment package</b> coupled with a <b>waiver</b> with respect to WTO rules on the grounds of policy space required for climate change mitigation and based on Article IX:3 and IX:4 of the Marrakesh Agreement.
	An <b>interpretative understanding</b> , as provided for under Article IX:2 of the Marrakesh Agreement. Such multilateral interpretations are meant to clarify the meaning of existing obligations, rather than to modify their content.	
<b>Options for reform or new rules</b>		
<b>Strengthening markets: tariff liberalization</b>		
Establish <b>list of environmental goods</b> that includes all key clean energy goods in the context of the EGA and eliminate bound tariffs to zero.		Finalize the DDA on EGS.
Ensure <b>coordination between the EGA and TiSA</b> for a coherent approach to CETs.		
Propose a mechanism that would make it easier for <b>countries outside the EGA to join</b> .		
Include some form of <b>special and differentiated treatment in the EGA</b> to address developing country concerns.		
<b>Strengthening markets: services &amp; regulatory issues</b>		
Work towards the <b>inclusion of services relevant for CETs in TiSA</b> , and for an eventual inclusion of TiSA under the WTO.	Agree to an understanding or an <b>annex to the GATS on clean energy services</b> , similar to the annex on telecommunications.	Address <b>domestic regulations</b> in the area of clean energy services under the WTO
Ensure <b>coordination between TiSA and the EGA</b> on goods for a coherent approach to CETs.	<b>Interpretative note to GATT, Art. V</b> , clarifying that <b>transit disciplines</b> cover electricity transit via fixed infrastructure and that the obligation for a member state to guarantee freedom of transit applies in any case, regardless of who owns the transportation infrastructure.	Finalize the DDA on EGS.

Short-term options	Medium-term options	Long-term options
Promote a <b>discussion under the WTO Committee on Trade and Environment</b> about identifying services relevant to the supply of CETs.	Countries make <b>reform commitments</b> reform based on the <b>understanding or annex</b> under TISA or the GATS.	Revisiting the application of <b>WTO transit rules</b> with respect to energy.
	Include <b>clean energy services in the EGA</b> .	Formulation of <b>WTO investment disciplines</b> to effectively address the construction of fixed infrastructure necessary for clean energy trade.
	<b>Additional commitments</b> either in an annex to the GATS on Energy Services or a Reference Paper to address competition issues and third party access to fixed infrastructure including <b>priority access for clean energy to the networks</b> whether exported / imported or domestically produced and consumed.	
	Addressing the issues related to <b>energy trade through fixed infrastructure</b> in a separate agreement, including a plurilateral one, under the auspices of the WTO devoted to energy trade (such as a Sustainable Energy Trade Agreement).	

**Policy space: subsidies & local content requirements**

An <b>interpretative understanding</b> to clarify concepts in the <b>ASCM</b> such as “benefit”, “specificity” and “financial contribution” as well as for example the relationship between GATT Article XX and ASCM.
A <b>waiver</b> from the <b>ASCM</b> that applies only to subsidies specifically addressing environmental externalities and made conditional on removing any discriminatory aspects within a set, relatively short time frame as well as other domestic policies inconsistent with the waiver objectives (e.g. fossil fuel subsidies). It could also contain an Article XX chapeau-like provision, requiring that policies under the waiver do not constitute arbitrary or unjustifiable discrimination.

Short-term options	Medium-term options	Long-term options
	An <b>interpretative understanding</b> of the <b>ASCM</b> to facilitate the conversion of ASCM-inconsistent <b>LCRs</b> into other kinds of WTO-consistent measures that ensure that recipients of clean energy subsidies provide benefits to the local economy.	
<b>Policy space: trade remedies</b>		
A <b>better enforcement of existing law</b> , for example by recognizing “Moore’s law” on learning curves and cost reductions over a product life cycle.	<b>Eliminate trade remedies</b> in RTAs and/or the EGA	In concluding the Doha negotiations on environmental goods, insert a <b>provision on the “non-use”</b> of trade remedies.
An undertaking by willing WTO members to engage in <b>consultations</b> as soon as they are aware that policies and practices in another member may give rise to trade remedy action in their jurisdiction.		Reform WTO rules on trade remedies in general (i.e. beyond their use in clean energy).
Make use of the <b>lesser-duty rule in remedy cases</b> in the area of clean energy; introduce a time limit for trade remedies on clean energy; and limit trade remedies on clean energy goods in scope.		
A commitment to <b>publish an objective study</b> of the costs and benefits of both the measures being responded to by trade remedies as well as the remedies themselves.		
Introduce a climate change criterion in <b>national public interest tests</b> .		
Introduce a <b>peace clause</b> on trade remedies on the clean energy sector in new RTAs and/or the EGA.		

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The International Centre for Trade and Sustainable Development (ICTSD) is an independent think-and-do-tank, engaged in the provision of information, research and analysis, and policy and multistakeholder dialogue, as a not-for-profit organisation based in Geneva, Switzerland.

Established in 1996, ICTSD's mission is to ensure that trade and investment policy and frameworks advance sustainable development in the global economy.



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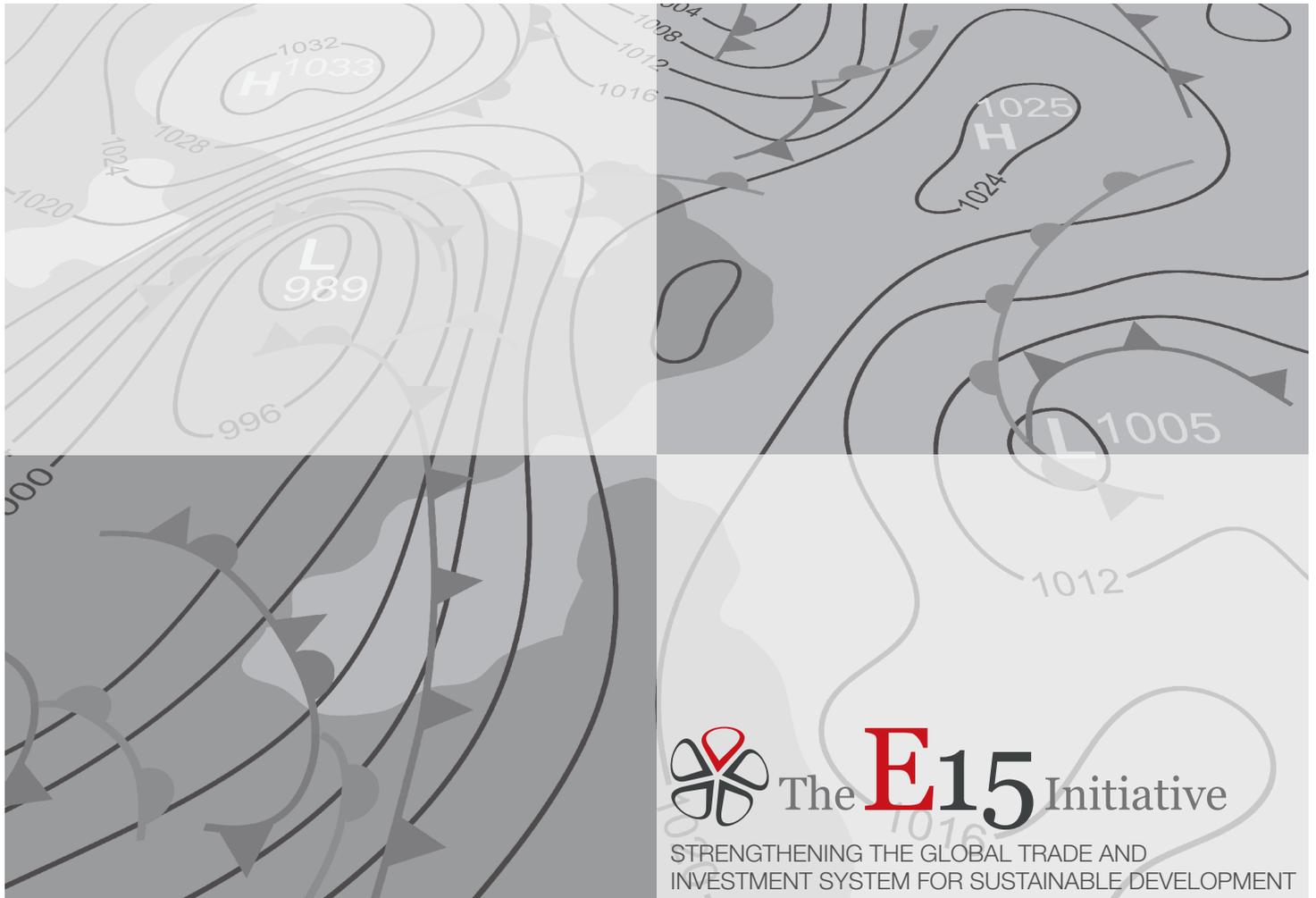
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# Global Rules for Mutually Supportive and Reinforcing Trade and Climate Regimes

Policy Options Paper



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# Global Rules for Mutually Supportive and Reinforcing Trade and Climate Regimes

James Bacchus

on behalf of the E15 Expert Group on Measures to Address Climate Change and the Trade System

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Measures to Address Climate Change and the Trade System. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15 Initiative and authored by group members. James Bacchus led the Expert Group and provided intellectual guidance. Thomas L. Brewer, Henry Derwent, and Ingrid Jegou formed the core team and contributed significantly to the process and final paper. The policy options offered for consideration should not be taken to represent full consensus on any or all of the offered options. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:

[www.e15initiative.org](http://www.e15initiative.org)

# Abstract

As the world intensifies its search for global solutions for climate change, far too little attention has been paid in global policy-making to the nexus between climate change and international trade. In particular, important opportunities for the trade system to contribute to addressing climate change have been overlooked. The overriding message addressed to both trade negotiators and climate negotiators in the present paper is that they must begin by acknowledging the inseparability of the two issues with the aim of framing global rules on trade and on climate that are mutually consistent, supportive, and reinforcing. With this objective in mind, the analysis behind the policy options centres on the interface between national and international measures taken to address climate change and the global rules of the WTO-based multilateral trading system. Where proposed climate rules are concerned, the main focus is on possible approaches that may have trade implications or that may otherwise be affected by the rules or rulings of the WTO. Where current or proposed trade rules are concerned, the focus is equally on the affirmative

ways that trade and trade rules can be used to advance climate actions, and on suggesting ways to avoid the potential collisions that may occur with the current trade regime when taking climate actions. The policy options are arranged in six subcategories: maximizing the ways trade can address climate change while minimizing conflicts between the trade and climate regimes; recognizing embedded carbon in trade and revisiting the concept of “like” products; fostering climate action through enabling the formation of climate clubs and coalitions; finding an agreed framework for emissions trading, carbon taxes, and border measures; making use of subsidies, standards, government procurement, and intellectual property; and, fostering sectoral approaches, including maritime shipping and aviation. The paper concludes that the policy options for dealing with the nexus of trade and climate change will only succeed if significant additional efforts are made by the trade and climate regimes to work together on behalf of the overriding global goals for sustainable development.

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Abbreviations	
ASCM	Agreement on Subsidies and Countervailing Measures
COP	Conference of the Parties
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GPA	Government Procurement Agreement
ICAO	International Civil Aviation Organization
IMO	International Maritime Organization
MC	Ministerial Conference
PPM	process and production method
TBT	Technical Barriers to Trade
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UNFCCC	United Nations Framework Convention on Climate Change
WTO	World Trade Organization

# Executive Summary

Trade rules and climate realities are rapidly approaching a crossroads. As the world intensifies its search for global solutions for climate change, far too little attention has been paid in global policy-making to the nexus between climate change and international trade. In particular, important opportunities for the trade system to contribute to addressing climate change have been largely overlooked. The E15 Expert Group on Measures to Address Climate Change and the Trade System, jointly convened by ICTSD and the World Economic Forum in partnership with Climate Strategies, has sought to bridge this gap.

Our overriding message to trade negotiators and to climate negotiators alike about how best to meet the global challenge of reconciling our goals for trade and for climate change is that they must begin by acknowledging the inseparability of the two issues. Based on this mutual acknowledgment, they must each acknowledge, too, the essential legitimacy of the goals of the other, and they must begin now, belatedly, to communicate. This communication must aim at framing global rules on trade and on climate that are mutually consistent, mutually supportive, and mutually reinforcing.

## Background

Neither the goals of the long-established global trade regime nor those of the newly-emerging global climate regime can be accomplished unless the two worlds of trade and climate endeavour can come together to work as one. In the absence, so far, of any structured communication between the climate and trade worlds, there is a prevailing air of mutual apprehension. Climate advocates fear that trade rules will keep us from fighting climate change. Trade advocates fear that making allowances for fighting climate change in trade rules will lead to an endless procession of other causes seeking such special allowances, which could undermine a global trading system more than half a century in the making. There is also a prevailing mutual procrastination. Each of the climate and the trade worlds is waiting for the other to act first on the issues that concern them both. Against this backdrop, the Expert Group has scrutinized at length opportunities for the trade system to contribute to climate action, and also for the trade system to inform climate action.

For reasons perfectly understandable within the challenging context of the climate negotiations, it is no longer anticipated that a future climate agreement will include general obligations for national cuts in greenhouse gas

emissions. Instead of binding commitments on cutting carbon emissions, the envisaged Paris agreement would include only voluntary “[intended] nationally determined contributions.” It is not expected that there will be any real disciplines in the agreement relating to the making or the meeting of these commitments on “contributions.” Moreover, there will most likely not be any effective mechanism in the climate agreement for settling disputes about these “contributions.”

What may be most important for purposes of international trade law is that, to date, there has been virtually no discussion by either climate negotiators or delegates to the WTO of the specific kinds of national measures that could be seen as “climate measures” taken to fulfil these voluntary “contributions,” or of how those national measures could be reconciled with WTO law if they restricted or otherwise affected trade in goods or services and, thus, fell within the scope of the WTO treaty. Therefore, it can already be anticipated that there will, in the aftermath of the conclusion of the Paris Agreement, be no agreed way of judging whether a national “measure” should be exempt or not from what would otherwise be WTO trade obligations. This omission from the climate debate is critical, and it affects in a variety of ways many of the policy options presented in the paper.

To keep from opening a Pandora’s box of global protectionism, the unique issue of climate change must be addressed by the members of the WTO in ways that are likewise unique. In framing our policy options for dealing with this issue within the global trade system, our focus is on the interface between and among national and international measures taken to address climate change and the global rules of the WTO-based multilateral trading system.

Our very strong view is that global climate rules and global trade rules must be consistent in both conception and in application. They must likewise be consistent in enforcement. Where proposed climate rules are concerned, our main focus is on possible approaches that may have trade implications or that may otherwise be affected by the rules or rulings of the WTO. Where current or proposed trade rules are concerned, our focus in these policy options is equally on the many affirmative ways that trade and trade rules can be used to advance climate actions, and on suggesting ways to avoid the potential collisions that may occur with the current trade regime when taking climate actions. The policy options are arranged in six subcategories between which there are a number of overlaps.

## Policy Options

*Maximizing the ways trade can address climate change while minimizing conflicts between the trade and climate regimes.* Most of the opportunities trade offers in the common struggle against climate change are currently being missed. The effort to address climate change must occur not only within the UNFCCC; it must also occur within the global trade system. There are a whole array of ways the WTO and other trade arrangements can be used affirmatively to maximize trade as a positive force in fighting and forestalling climate change. At the same time, it is necessary to anticipate potential conflicts and to prevent legal collisions between WTO rules and national and international measures taken to address climate change. The seven options offered in this subcategory deal with what can be anticipated as a legal overlap between the existing WTO-based trade regime and the various combinations of newly constructed climate regimes that may emerge.

*Recognizing embedded carbon in trade and revisiting the concept of “like” products.* The concept of “like” products is part of the foundation of the trade system. The determination of “likeness,” which has been the subject of endless jurisprudence, has not been made on the basis of how products are made or what goes into making them. A legal determination in WTO dispute settlement that two products are not “like” based on the amount of carbon used in making them would be unprecedented. In our view, the uniqueness of the existential global challenge of climate change fully justifies carving out some kind of a limited exception for distinctions between and among traded products on the basis of carbon use and carbon emissions. At the same time, we are mindful of the legitimate fear in the trade regime that doing so as part of a “likeness” determination could open the door to other distinctions that could threaten the overall trading system. We offer two options that seem to us to combine the most benefit for the climate at the least risk to trade.

*Fostering climate action through enabling the formation of climate clubs and coalitions.* In the absence of a universal and comprehensive approach to climate change we are anticipating the continued conclusion of various partial and limited climate-related agreements by clubs of some countries, and perhaps including in certain instances subnational and/or non-state political actors. Given the strong potential of such arrangements to complement multilateral action, it is, in our view, imperative that the trade and climate regimes be mutually supportive of plurilateral climate action, and able to respond positively to this development. We offer four options, mindful that this must be done with due consideration for the WTO core principle of non-discrimination, and that there may be potential for framing climate-related clubs as plurilateral agreements within the WTO and as part of free trade agreements permissible under the WTO treaty.

*Finding an agreed framework for emissions trading, carbon taxes, and border measures.* Among the fragmented responses to climate change post 2015, we can expect the proliferation of a range of policies to price carbon, including emissions trading, carbon taxes, and possibly border measures. Putting a price on carbon is essential to climate change mitigation. But doing so in a largely uncoordinated manner enormously complicates the options for preventing a collision between the trade and climate regimes. It does so especially with respect to the array of trade restrictive border measures, which could be implemented by countries for fear of carbon leakage and also as political concessions for the acquiescence of domestic producers to national restrictions on carbon emissions. We offer two options that respond to one of the main concerns in the climate-trade interface: that of unnecessarily restricting trade for climate reasons.

*Making use of subsidies, standards, government procurement, and intellectual property.* A key challenge in addressing climate change is to provide at a minimum a level playing field between clean and fossil energies. In addition to putting a price on carbon, it is essential to stop subsidizing it. We believe that the WTO has a role to play in this context, because fossil fuel subsidies are likely to affect competition and trade. Moreover, to address climate change, it will be necessary to stimulate the production and use of low-carbon products. Towards this end, a range of policy instruments are being used by policy-makers, including the use of subsidies, standards, intellectual property rules, and government procurement. In some cases, there is a lack of clarity on what is allowed and what is not, creating a zone of uncertainty that the six policy options offered in this category would seek to address.

*Fostering sectoral approaches, including maritime shipping and aviation.* In tackling climate change, where progress among smaller groups of stakeholders on a limited set of issues at a time is more easily within reach than a global, comprehensive deal, it is relevant to also revisit the concept of sectoral deals. Sectoral rules can be the building blocks towards global rules. For our final three policy options, we have considered two sectors with a clear trade link and with abatement opportunities at hand: international shipping and aviation.

## Next Steps

The trade regime and the climate regime are moving forward on many interrelated issues affecting the intersection of trade and climate change. None of the policy options for dealing with the nexus of trade and climate change will succeed if significant additional efforts are not made by both regimes to work as one on behalf of our overriding global goals for sustainable development. The intent in offering our set of policy options is to be thought-provoking. It is not to be definitive. We certainly do not anticipate that all of these options will be implemented. We hope to inspire considered deliberation by trade and climate negotiators and other decision-makers alike. We hope too that this considered deliberation will help inspire action.

# 1. Introduction

Trade rules and climate realities are rapidly approaching a crossroads. As the world rightly intensifies its search for global solutions for climate change, a vast number of climate-related concerns are already consuming climate negotiators. To this number must be added the relationship between international trade and climate change. Far too little attention has been paid in global policy-making to the nexus between climate change and trade. In particular, important opportunities for the trade system to contribute to addressing climate change have been largely overlooked. The E15 Expert Group on Measures to Address Climate Change and the Trade System, jointly convened by ICTSD and the World Economic Forum in partnership with Climate Strategies, has sought to bridge this gap.

Economically, environmentally, and in every other way, the linkage between trade and climate change in global governance is unavoidable and inescapable. Climate actions—which, in the current expectation, are to be nationally determined—will necessarily affect terms of trade. On the other hand, trade has a direct impact on emissions, positive and negative, through transport and also through the use of resources. Trade can also play an important role in mitigation as well as adaptation by fostering access to goods such as food, and also by speeding the spread of clean new technologies.

The two compelling matters of trade and climate change—both urgent global concerns—simply cannot be separated. One cannot be addressed without affecting the other, and, without doubt, we must address both. The world must find the best way to continue lowering barriers to international trade, so as to spur growth and development, while also combating climate change. We need the right global rules for both, and we need to think creatively about how to navigate within existing rules so as to make the most out of the policy space that is already there. The rules we choose to use to address one must be consistent with the rules we choose to use to address the other.

We see the need for additional efforts by global climate negotiators to acknowledge the existence of international trade rules. We see, equally and especially, the need for constructive dialogue on possible changes to some of those trade rules by the WTO. We also see a need for enhanced use of various committees and fora under the WTO, as well as the United Nations Framework Convention on Climate Change (UNFCCC) and other intergovernmental organizations, for promoting discussion and information exchange to further synergies and make the most out of opportunities, while at the same time addressing possible

areas of tension. Importantly, we see a need for the multilateral fora to foster action from the “bottom-up”—including through plurilateral efforts.

In our view, the key to identifying the improvements needed in trade rules can be found by keeping the promise made by the members of the WTO in the preamble to the Marrakesh Agreement that established the WTO. Originally, in 1947, the 23 countries that signed the General Agreement on Tariffs and Trade (GATT) professed their shared desire, in the preamble to the GATT, for “developing the full use of the resources of the world and expanding the production and exchange of goods.” In contrast, in 1994, the more than 100 countries that agreed to transform the GATT into the WTO through the conclusion of the Marrakesh Agreement expressed their shared desire for “the optimal use of the world’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of development.”

As we see it, this clear distinction between a desire for “full use” and “optimal use” of the world’s resources consistent with sustainable development is a distinction that makes a crucial difference for the WTO. The Appellate Body of the WTO seems to us to see this distinction in much the same way. In pointing to the presence of a commitment to “sustainable development” in the Marrakesh Agreement, the Appellate Body has observed that the signatories “to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy.”<sup>1</sup> There is all the more reason for the members of the WTO to be fully aware of this in 2016.

One essential way for the members of the WTO to help keep their promised commitment to sustainable development is by fully addressing the relationship between trade and climate change in all that they do going forward.

Similarly, while carrying out efforts to address climate change, parties to the UNFCCC should be held accountable to their commitment as expressed in Article 3.5 of the Convention, “... Parties should cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties, thus enabling them better to address the problems of climate change. Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.”

<sup>1</sup> Appellate Body, United States – Shrimp, WT/DS58 (1998), para. 129 and footnote 107.

# 2. Background: Diverging Trade and Climate Regimes

## 2.1. Mutual Misunderstanding

Trade and climate policy-making communities exist side by side but rarely interact directly. Because of this, in part, they are two worlds with insufficient mutual understanding. Those who are devoted most to removing barriers to trade worldwide often do not put the fundamental legitimacy of climate and environmental concerns at the top of their priorities. Similarly, those who are devoted most to addressing climate change and to mitigating other environmental harms often give too little thought to the equally fundamental legitimacy of trade and other economic concerns, which constitute the basis for growth and sustainable development.

The two worlds of trade and climate have different goals, different regimes, and even a host of different acronyms and jargon that frustrate communication and that hinder reconciliation through a common undertaking. To cite only one of many examples, some of the trade advocates among us were surprised to learn in our deliberations that climate advocates speak of “border tax adjustments” generically, while some of the climate advocates among us were equally surprised to learn that, in trade, a “border tax adjustment” is a legal term of art referring to a specific provision in a specific trade treaty obligation. Thus, climate policy-makers may be considering using trade measures, or may fear that others do, without being fully aware of the legal framework regulating them. This is just one example of the mutual misunderstandings that exist between the climate and the trade worlds, which make progress on addressing the issues of “trade and climate change” all the more difficult.

This mutual misunderstanding must end. Not least, this must be done for the sake and in the service of the poorest in the world. The millions upon millions of people still mired in poverty are the most in need of the economic growth that freer trade can help produce, and they are also the most at risk from the devastations and dislocations of continued climate change. Jim Yong Kim, the president of the World Bank, has spoken often of “the intrinsic link between climate change and poverty,” and all empirical evidence supports him. Pope Francis has reminded us recently of “the intimate relationship between the poor and the fragility of the planet,” and of the fact that “both everyday experience and scientific research show that the gravest effects of all attacks on the environment are suffered by the poorest.” The poorest among us need both economic growth and help against the harmful effects of climate change.

And, in truth, so do we all. The world as a whole needs the right blending of economic growth, social inclusion, and environmental protection that can only come through a shared sustainable development. Neither the goals of the long-established global trade regime nor those of the newly-emerging global climate regime can be accomplished unless the two worlds of trade and climate endeavour can come together to work as one.

Our overriding message to trade negotiators and to climate negotiators alike about how best to meet the global challenge of reconciling our goals for trade and for climate change is that they must begin by acknowledging the inseparability of the two issues. Based on this mutual acknowledgment, they must each acknowledge, too, the essential legitimacy of the goals of the other, and they must begin now, belatedly, to communicate. This communication must aim at framing global rules on trade and on climate that are mutually consistent, mutually supportive, and mutually reinforcing.

## 2.2. Multilateral Rules and Trade Restrictions

If pressed as to what, above all else, we wish to emphasize to global decision-makers, we would start by telling them this: where climate change is concerned, international trade and all the other aspects of global market commerce cannot be ignored; and where international trade is concerned, global climate change is a unique issue that must be addressed uniquely. We would also tell them this: it is perhaps unavoidable that, in legitimately addressing climate change, the governments of the world will impose some restrictions on trade.

One issue of concern for the trade and the climate communities alike is that of trade restrictions for climate purposes (Derwent 2015). Given the unavoidability of at least some climate-related trade restrictions, the right question is not whether there should be any such restrictions. The right question is: which restrictions should there be? Crucial related questions are: how can we make certain that any such trade restrictions are truly being imposed for legitimate climate reasons pursuant to legitimate climate measures? And, also, how can we keep any legitimate trade restrictions imposed for climate reasons from morphing into a multitude of illegitimate trade restrictions imposed for a host of other reasons? How do we keep necessary climate efforts from undermining a global trading system more than half a century in the making?

The right restrictions will be those that address climate change uniquely as a common global concern that is altogether unprecedented and altogether unlike all other global concerns that might be cited as justification for imposing trade restrictions. There are, to be sure, many other pressing concerns in the world. In any number of ways, the global trade system must—and does—take them into account. But none of those other concerns justifies making changes in WTO rules that would risk an unravelling of decades of global accomplishment in building the WTO-based multilateral trading system. Nor can we risk undermining the ongoing efforts within that system to continue to reduce global poverty and increase global prosperity by lowering the remaining barriers to trade. Climate change is different. Climate change is unique. Climate change threatens the very fate of human civilization and of the planet.

In the absence, so far, of any structured communication between the climate and trade worlds, there is a prevailing air of mutual apprehension. Climate advocates fear that trade rules will keep us from fighting climate change. Trade advocates fear that making allowances for fighting climate change in trade rules will undermine trade and lead to an endless procession of other causes seeking such special allowances. There is also a prevailing mutual procrastination. Each of the climate and the trade worlds is waiting for the other to act first on the issues that concern them both.

In an effort to end this procrastination, and to help spur mutual climate and trade action, we have aired these fears ourselves at length in our own deliberations. In airing them we have been struck, one and all, and most of all, by how misplaced many of these fears really are. The climate advocates among us have come to see that trade rules already respect the environment, and that numerous trade rulings have evidenced this respect. Similarly, the trade advocates among us have seen that, far from minimizing trade and other market concerns, the climate advocates see those concerns as central to solving our climate dilemmas. From this illuminating exchange, we have concluded, each and all, that the right mix of climate rules and trade rules going forward can eliminate the fears of climate and trade advocates alike while also fulfilling our goals for climate and for trade.

### **2.3. Opportunities for the Trade System to Contribute to Climate Action**

In addition to eliminating fears and enhancing mutual understanding, we have scrutinized at length opportunities for the trade system to contribute to climate action, and also for the trade system to inform climate action. We have observed, for example, that there is an increased tendency for climate action and policies between groups of countries that are more ambitious, for various reasons, to design and implement at a national, regional, or plurilateral level, or even between non-state actors and nation states. We believe that it is crucial that the trade and the climate systems respectively be supportive of these developments, in the interest of enhanced action. Indeed, although many of us consider multilateral action as the preferred way forward,

all of us share an increasing understanding that plurilateral action may be a powerful complement to multilateral action, and, if constructed carefully, can pave the way for progress in the multilateral settings.

Our Group has explored the case for such climate clubs, and has discussed how they relate to trade (Victor 2015; Leycegui and Imanol 2015; and, Petsonk and Keohane 2015). We see several possible roles for trade to play in this context—for instance in promoting necessary climate technology transfer between club members. Whereas the trade rules may not pose direct obstacles to the success of climate clubs, those rules could be further clarified to remove uncertainty and even to make explicit reference to climate change. In addition, in the specific case of climate action, a few actors moving ahead with more ambitious action is associated with risks of both “free riding” and of apprehensions of distortions to competitiveness and of carbon leakage, at a scale that depends on multiple factors. For this reason, allowing the use of some trade-restrictive climate measures may be perceived as a key element for mitigating those risks, and may thus make a significant practical difference to the successful emergence and establishment of clubs.

One concern for trade as well as for climate constituencies is the carbon embedded in trade. Indeed, the embedded carbon in trade has increased significantly in recent decades. This has occurred mostly as a consequence of industrialization, specialization, and the globalization of value chains, and not because of carbon leakage. This said, the uniqueness of the challenge posed by climate change argues for scope for policy-makers to consider options for allowing trade in goods and services with relatively low carbon content to be treated more favourably, so as to help stimulate the shift to a low carbon economy (Cottier 2015). Although encouraging this shift may be one of the most important contributions the trade system could make to climate action, finding the best way to do so is also one of the most challenging issues on which the climate and trade worlds must find common ground. Not surprisingly, this has indeed proven to be a difficult challenge for our Group. The issue of “likeness” is one of the founding and fundamental principles of the WTO framework. It is the legal glue holding together the two basic principles of non-discrimination between and among traded products—the “national treatment principle” and the “most-favoured-nation principle.” Any deviations from the traditional legal notions of “likeness” between and among traded products must be carefully weighed, so as to be effective in addressing climate change, and equally effective in preserving the trading system for now and for the future.

Thus, we wish to emphasize the unique opportunity presented for cooperation between the WTO and the UNFCCC on trade and climate change. And, with hopeful anticipation of such cooperation, we wish also to stress—specifically for purposes of the WTO trading system—the utter uniqueness of climate change. To keep from opening a Pandora’s box of global protectionism, the unique issue of global climate change must be addressed by the members of the WTO in ways that are likewise unique.

## 2.4. An Elusive Universal and Comprehensive Climate Treaty

For all of the long-held hopes of so many in the world, the chances of concluding a universal and comprehensive climate treaty which will effectively resolve the problem of climate change seem, to us, remote. At the same time, it seems unlikely to us that nothing at all will be concluded. At the time of writing, considerable progress has been made towards a positive outcome at the UN climate change conference in Paris that could point the way towards more positive outcomes beyond. There are considerable political pressures worldwide to reach an arrangement. For this reason, we are hopeful of the conclusion of a meaningful international agreement that, over time, will help humanity to avoid worldwide temperature increases that exceed 2 degrees Celsius (3.6 degrees Fahrenheit).

The broad outlines began to emerge in Lima of an “agreement” in Paris that would be universal but that would also be decidedly limited. For reasons perfectly understandable within the challenging context of the climate negotiations, it is no longer anticipated that a future climate agreement will include general obligations for national cuts in greenhouse gas emissions. Instead of binding commitments on cutting carbon emissions, the envisaged agreement would include only voluntary “[intended] nationally determined contributions.”<sup>2</sup> Conceivably, every country would agree to make some such a voluntary national “contribution”—a vital advance from the Kyoto Protocol where only a list of developed countries committed to emission reductions.

Significantly, however, it is not envisaged at this time that there will be any commonly agreed nomenclature in the Paris Agreement for either defining or harmonizing these voluntary national “contributions.” Furthermore, it is at the moment unclear whether parties to the UNFCCC will be able to agree on clear metrics that could be used to make comparison between these “contributions.” Additionally, it is not expected now that there will be any real disciplines in the Paris Agreement relating to the making or the meeting of these commitments on “contributions.” Not least, and importantly, there will most likely not be any effective mechanism in the climate agreement for settling disputes about these “contributions.” The current draft of the proposed climate agreement (October 2015) simply incorporates by reference the dispute settlement provisions in the UNFCCC—which are optional, and have never been used.<sup>3</sup>

Moreover, what may be most important for purposes of international trade law is that, to date, there has been virtually no discussion by either climate negotiators or delegates to the WTO of the specific kinds of national measures that could be seen as “climate measures” taken to fulfil these voluntary “contributions,” or of how those

national measures could be reconciled with WTO law if they restricted or otherwise affected trade in goods or services and, thus, fell within the scope of the WTO treaty. Therefore, as of now, it can be anticipated that post 2020 there will be no reliable way of discerning from the Paris Agreement whether a national “measure” supposedly taken in furtherance of a “contribution” promised in fulfilment of that agreement would be a “climate measure” or not. And, it can thus already be anticipated that there will, in the aftermath of the conclusion of the Paris Agreement, be no agreed way of judging whether such a national “measure” should be exempt or not from what would otherwise be WTO trade obligations. This omission from the climate debate is critical, and it affects in a variety of ways many of the options presented in the next section of the paper.

## 2.5. Dealing Uniquely with Climate Change in the Global Trade System

In framing our offered policy options for dealing uniquely with the issue of climate change within the global trade system, we are mindful that there are many different concerns relating to the climate, and also that there are many different alternative means for addressing the same concerns through trade. There can be new rules. There can be revised rules. There can be “decisions” and “interpretations” and “waivers.” There can be trade reviews and committee actions. There can also be WTO dispute settlement. And there can be ways for decision-makers to work within the existing trade rules. In a number of instances, we offer one particular approach as a policy option. In others, we offer several possible approaches for consideration by global decision-makers.

Each of the policy options that follow garnered broad support within the Expert Group. However, it is safe to say that none of us agrees on all of them. We have not sought to achieve a consensus on our list of policy options. We have instead chosen to identify and to offer as broad a selection of options as possible for due consideration by all of those entrusted with decision-making on the interrelationships between trade and climate change.

Our focus in all of the policy options is on the interface between national and international measures taken to address climate change and the global rules of the WTO-based multilateral trading system. Our focus is *not* on all else that could and should be done by the WTO to keep its promise to promote “sustainable development.” Moreover, it is *not* on how best to structure a global climate treaty—although, clearly, that considerable challenge is unavoidably related to the interface between climate and trade, and therefore we do include some options for climate decision-makers.

<sup>2</sup> Once an agreement reached, however, these contributions would no longer be referred to as “intended” but simply as nationally determined contributions.

<sup>3</sup> Article 21 in the draft agreement text dated 5 October 2015, referring to Article 14, UNFCCC.

Our intent in offering this list of policy options is to be thought-provoking. It is not to be definitive. We see the list of policy options that follows as, more than anything else, a long “checklist” of possibilities for decision-makers to consider. We certainly do not anticipate that all of these policy options will be implemented. As we explain, some are offered in the alternative. We hope to inspire considered deliberation by trade and climate negotiators and other decision-makers alike. We hope too that this considered deliberation will help inspire action.

The options are arranged in subcategories. However, there are overlaps. For instance, options for addressing embedded carbon would be useful for elaborating rules for carbon taxes and border measures. Similarly, options in the area of “clubs” are relevant for sectoral approaches. There is no hierarchy of the offered options, and no suggested sequencing. Having said that, some options are, of course, clearly more within reach over a short to medium time horizon than others.

Our very strong view is that global climate rules and global trade rules must be consistent in both conception and in application. They must likewise be consistent in enforcement. Where proposed climate rules are concerned, our main focus in what follows is on possible approaches that may have trade implications or that may otherwise be affected by the rules or rulings of the WTO. Where current or proposed trade rules are concerned, our focus in these policy options is equally on the many affirmative ways that trade and trade rules can be used to advance climate actions, and on suggesting ways to avoid the potential collisions that may occur with the current trade regime when taking climate actions.

# 3. Policy Options for Mutually Supportive Regimes

## 3.1. Maximize Trade Solutions to Climate Change and Minimize Regime Conflicts

Trade offers opportunities as well as constraints in the common struggle against climate change. Most of these opportunities are currently being missed, and it is, as we see it, vital that they be seized. The effort to address climate change must occur not only within the UNFCCC; it must also occur within the global trade system. Trade can be green, and world trade rules can be transformed into better tools for making it so.

In some ways, this is already happening—such as in the current negotiations on eliminating duties on environmental goods, and in regional trade agreements that include provisions on climate change. In other ways, trade initiatives aimed at addressing climate concerns have yet to unfold. Although WTO rules do acknowledge and respect environmental concerns, there are numerous additional ways in which the trade regime can contribute to the achievement of climate goals. Several such options can be found throughout this paper. Through the WTO as well as bilateral and regional trade agreements, trade rules can be used also to help minimize carbon emissions along global supply chains, help shrink fossil fuel subsidies, help promote the development of renewable energy, and much more. Other expert groups in the E15Initiative have suggested numerous such positive innovations for the trade system. Because they have done so, we do not repeat many of those affirmative policy options here. But we do stress that they must not be overlooked.

At the same time, it is, in our view, necessary to anticipate potential conflicts and to prevent legal collisions between WTO rules and national and international measures taken to address climate change. Such possible collisions will differ depending on which climate scenarios unfold in the near future.

The options below deal with what can be anticipated as a legal overlap between the existing WTO-based trade regime and the various combinations of newly constructed climate regimes that may emerge. Under most of the likely climate scenarios, there will be an irresistible temptation to impose trade restrictions and trade sanctions as ways of ensuring the enactment and the enforcement of national climate measures. Climate measures, moreover, can be expected also to affect trade in many other ways, and, by so doing, fall within the scope of the WTO treaty. For this reason, whatever scenario may prevail in the unfolding climate negotiations, drawing a legal line upfront between the trade-affecting climate measures that are permissible and those

that are not is imperative. This is true for the global climate negotiations; it is also true for any negotiations that may result in the formation of “climate clubs.”

Ideally, this legal line should be drawn in concert through coordinated legal actions by the parties of the UNFCCC and by the members of the WTO. In the alternative, the line could be drawn in a legal action taken by either one in consultation with the other. An action by the UNFCCC rather than by the WTO would then be preferred. Nearly all of the members of the WTO are parties to the UNFCCC; whereas an action by the WTO would bind only a smaller group of countries. Non-WTO countries would remain free to take any trade-affecting climate measures they wished (just as WTO members remain free to impose any trade discrimination on them that they wish). In contrast, an action by the Conference of the Parties (COP) would politically, if not legally, bind all UNFCCC parties, including nearly all of the members of the WTO. Ideally, such a COP action could then be echoed and endorsed in a separate and simultaneous action by the WTO—although, even in the absence of a specific WTO action of endorsement, it is highly likely that such a COP action would be given due respect as part of public international law in any subsequent WTO dispute settlement.

Unfortunately, as it is, too little thought has been given to the questions of when, where, and how to draw this needed legal line either in UN climate negotiations or in ongoing WTO trade negotiations. To the extent that those involved have considered these questions at all, they have evidently assumed that these questions will be addressed in due course as part of the inter-organizational and procedural “end game” whenever the COP finally approaches the hoped-for conclusion of a universal and comprehensive climate treaty. The COP climate negotiators seem to assume that, at that time, the WTO will endorse the new climate rules agreed by the COP; the trade negotiators seem to assume that, at that time, the COP will reaffirm in the Paris Agreement the long-standing international commitment to the established trade rules of the WTO.

As a consequence, endless legal questions—most of them left largely unanswered during more than half a century thus far of GATT/WTO jurisprudence—will be likely to arise under international trade law. There is something considerably less than a lack of clarity in international trade law about whether some of the climate measures contemplated by some of the parties to the UNFCCC would be permissible current WTO rules or not. If neither climate negotiators nor trade negotiators draw a legal line or provide guidance regarding what is a legitimate and lawful climate measure affecting

trade and what is not, then that line will have to be drawn on a case-by-case basis as individual disputes arise; and, in the absence of any mandatory climate dispute settlement mechanism, that line will be drawn by WTO jurists in WTO dispute settlement. In other words, a decision by UN climate negotiators *not* to include a mandatory climate dispute settlement mechanism in the Paris Agreement is *not* a decision to forego dispute settlement over climate disputes that affect trade. Rather, it is a decision *de facto* to leave the settlement of trade-related climate disputes to the WTO. Furthermore, the absence of any agreed definition of what constitutes a “climate measure” in the Paris climate agreement would be a decision *de facto* to leave the clarification of the meaning of “climate measure” to WTO jurists on a case-by-case basis.

Entrusting WTO jurists with such disputes is not necessarily the wrong result. In a series of landmark rulings during the first two decades of WTO dispute settlement, WTO jurists have demonstrated, time and again, that they will not automatically permit trade to trump environmental concerns. Yet this is not a jurisdictional result that should happen inadvertently. Nor is it one that should occur without considerable shared discussion among climate and trade negotiators alike. Moreover, if there is to be no mandatory climate dispute settlement mechanism, and if WTO jurists will therefore be expected to judge these disputes, it would be best, by far, if they were given more and better guidance by those negotiating both on the climate and on trade. At a bare minimum, each of the climate and trade regimes should acknowledge legally the legitimacy of the other. This can best be done in the treaty texts that govern those regimes.

In view of the above, and in order to maximize the ways trade can address climate change while minimizing conflicts between the trade and climate regimes, we offer the following options.

#### Policy Option 1

Enhance the mutual understanding between the trade and climate regimes through recognizing the legitimacy of each regime and through a greater use of existing fora, such as the Committee on Trade and Environment and the Trade Policy Review Mechanism of the WTO as well as the Subsidiary on Body Scientific and Technological Advice of the UNFCCC, for assessing the implications of one regime for the other.

#### Policy Option 2

Strengthen the WTO Trade Policy Review Mechanism to include a required assessment of the impact of relevant domestic measures on climate change, and also on efforts to address climate change.

#### Policy Option 3

Continue to explore the role for a formal and mandatory climate dispute settlement mechanism in the UNFCCC and in other international climate agreements.

#### Policy Option 4

In the UNFCCC, include an agreed means for measuring, reporting, and verifying measures taken to implement Intended Nationally Determined Contributions (INDCs) as well as a definition that can be used for purposes of identifying “climate measures” in trade and other dispute settlement.

#### Policy Option 5

Have the WTO agree that it will be bound for purposes of WTO dispute settlement by the judgments in any climate dispute settlement mechanism relating to climate compliance under those agreements. Provide that:

- a) A national measure taken by WTO members which is found to be in furtherance of a national climate “contribution” in a climate agreement will be respected in WTO dispute settlement, and that such a measure will be exempt from what would otherwise be that WTO member’s WTO obligations;
- b) Trade sanctions taken by one WTO member against goods or services of another WTO member pursuant to the terms of a climate agreement to which both those WTO members are parties will be considered to be in compliance with WTO obligations.

#### Policy Option 6

Through a decision or some other legal action by the members of the WTO, create a legal breathing space by establishing a “peace clause” for climate action. Such a “peace clause” could require WTO members to wait at least three years before challenging national climate measures or countermeasures that restrict trade or otherwise have trade effects in WTO dispute settlement.

#### Policy Option 7

Through a common action by the UNFCCC and the WTO, clarify the differences, if any, between the concept of “common but differentiated treatment” in the climate regime and the concept of “special and differential treatment” in the trade regime, and, further, clarify the ways and the extent to which these forms of treatment should be acknowledged in dispute settlement involving trade-related climate measures.

### 3.1. Recognize Embedded Carbon in Trade and Revisit the Concept of “Like” Products

Trade obligations are generally obligations relating to the traded products themselves, and not to the particular traders or to the individual countries that are part of the trade system. The most basic trade obligations therefore relate to how the products themselves are treated in international trade. The most-favoured-nation obligation is an obligation not to discriminate between and among products from different foreign countries. The “national treatment” obligation is an obligation not to discriminate in favour of domestic products over the products from a foreign country. At the most basic level, these elementary obligations in the trading system can work only if we have some way of identifying which particular traded products are to be compared when determining whether these obligations are being respected. For this reason, trade rules have long stated that the comparison must be between “like

products.” Thus, the concept of “likeness” of products is part of the very foundation of the trade system.

What is, or is not, a “like product” has been the subject of endless jurisprudence in the trade system. In trade jurisprudence, the determination of whether products are “like” or not has been made on the basis of four criteria of “likeness”: (1) the properties, nature, and quality of the products; (2) the end-uses of the products; (3) consumers’ tastes and habits in respect of the products; and (4) the tariff classification of the products. The determination of “likeness” has not been made on the basis of how products are made or on the basis of what goes into making them.

Under this jurisprudence, a distinction made between products on the basis of the amount of carbon that is used in making them is not justified. A legal determination in WTO dispute settlement that two products are not “like” based on the amount of carbon used in making them would be unprecedented. Conceivably, such a ruling could open the door to all kinds of other “likeness” distinctions based on other “processes and production methods” (commonly called PPMs). If a distinction on the “likeness” of products for purposes of determining whether there has been a violation of a WTO obligation can be made on the basis of the amount of carbon that is used in making them, then what other distinctions on what other bases can be made relating to PPMs? Where do we draw the line?

In our view, the uniqueness of the existential global challenge of climate change fully justifies carving out some kind of a limited exception for distinctions between and among traded products on the basis of carbon use and carbon emissions. At the same time, we are mindful of the perfectly legitimate fear in the trade regime that doing so as part of a “likeness” determination could open the door to other distinctions that could threaten the overall trading system. We have considered—at length—numerous possible alternatives. We have settled on two options that seem to us to combine the most benefit for the climate at the least risk to trade. To thread this legal and political needle, we offer an approach consisting of two linked policy options.

#### Policy Option 8

Initiate a joint effort by the WTO, the UNFCCC, and other relevant international institutions to establish an agreed common international standard for calculating the amount of carbon used in the making of traded products;

and,

#### Policy Option 9

Agree on a “waiver” from WTO obligations for all trade restrictive “climate measures” that are based on the amount of carbon used in making a product and that are taken in furtherance of and in compliance with a UNFCCC climate agreement or with a plurilateral “climate club.”

This approach is not without precedent. In rare instances—such as with conflict diamonds—waivers have been granted for limited purposes and in unique circumstances by the WTO for what would otherwise be actions inconsistent with WTO obligations. Climate change is suitably unique. However, here we emphasize two things: first, the importance of a carefully drawn “waiver” that will clearly define the limits of such permitted measures; and second, the imperative that the climate regime itself defines what precisely is a “climate measure.” Otherwise, jurists for the trade regime will do so in the context of discrete disputes in WTO dispute settlement.

Such a waiver would open up a series of opportunities for the trade system to support climate action. For example, this would make it possible for the members of the WTO to clarify, through a decision, that, in the definition of a “technical regulation” in the WTO Agreement on Technical Barriers to Trade (TBT), the word “related” modifying “processes and production methods” includes the energy used or the carbon emitted in making a product.<sup>4</sup> This would legally justify legitimate climate-related actions that take the form of technical regulations. Similarly, this approach would make it possible to amend WTO rules to provide that the amount of carbon used in making imported products from a WTO member can be calculated and included when applying countervailing duties to subsidies or anti-dumping duties to those products.<sup>5</sup> In addition, it would be possible to give consideration to linking the permissible use of tariff concessions involving process and production methods relating to embedded carbon in a specific product. (See further section 3.4 below.)

The granting of such a waiver may be an option not easily within reach. There are the concerns of the trade regime we have already described, and there is also the perception of a North/South divide on the issue of embedded carbon. This relates to the fact that while a number of developed countries have already managed, to some extent, to reduce their production-based emissions, they have not yet reduced their carbon consumption. Much of the world’s emission-intensive production is increasingly being imported from developing or emerging economies. Thus, the burden of the waiver we have offered for consideration would fall more heavily on developing countries if not accompanied by other actions to help assure them of equal competitive opportunities in the global marketplace. Such actions should include, but not be limited to: the enhanced transfer of low-carbon technologies to developing countries, and the provision to developing countries of adequate financing for climate mitigation and climate adaptation (Cottier 2015).

<sup>4</sup> See Annex 1 to the TBT Agreement.

<sup>5</sup> See the Agreement on Subsidies and Countervailing Measures and the Anti-Dumping Agreement

### 3.3. Foster Climate Action Through Enabling the Formation of Climate Clubs and Coalitions

As previously indicated, in the absence of a universal and comprehensive approach to climate change we are anticipating the continued conclusion of various partial and limited climate-related agreements by “clubs” of some (but not all) UN member countries, and perhaps including in certain instances subnational and/or non-state political actors. Given the strong potential of such arrangements to complement multilateral action, it is imperative that the trade and climate regimes be mutually supportive of plurilateral climate action, as well as action undertaken by non-state actors or by cities, municipalities, and sub-regions, and be able to respond positively to this development. This said, we are mindful that this must be done with due consideration for the core principles of non-discrimination of the WTO. We are mindful too that there may be potential for framing climate-related “clubs” as plurilateral agreements within the WTO and as part of free trade agreements permissible under the WTO treaty. Moreover, they could be part of regional trade arrangements made outside the WTO.

Relevant in this context is an open question in WTO jurisprudence: can climate and other environmental measures applied by a WTO member be entitled to the general exceptions for what would otherwise be WTO trade obligations for trade in goods under Article XX of the GATT and, for trade in services, Article XIV of the General Agreement on Trade in Services (GATS), only if they address environmental harms within the territorial jurisdiction of that WTO member? Or can those measures also be entitled to those general exceptions if they address environmental harm that occurs elsewhere—such as carbon emissions in the territorial jurisdiction of another WTO member?

We offer the following options on climate clubs and coalitions.

#### Policy Option 10

Members of the WTO should affirm by a decision that climate measures taken pursuant to a climate agreement of the UNFCCC are measures falling within the scope of Article XX of the GATT and of Article XIV of the GATS, and will be entitled to the benefit of those general exceptions to the obligations in the WTO treaty, provided they comply in their application with the conditions to those exceptions reiterated in Article 3.5 of the UNFCCC.

#### Policy Option 11

Members of the WTO should agree on a set of circumstances in which there would be a presumption in favour of granting a waiver for a climate-related “club” organized outside the framework of the WTO to become a “plurilateral” agreement under the WTO treaty. Members of the plurilateral could commit to a set of rules on climate change that would be binding solely on them and would be fully enforceable in WTO dispute settlement.

#### Policy Option 12

Through a decision by the members of the WTO:

- a) Affirm that an agreement by a climate “club” to provide “WTO-plus” trade benefits over and above those due under the WTO treaty to WTO members that are members of that “club,” and not to those WTO members that are not “club” members, is permissible under WTO rules;
- b) Provide that trade sanctions taken by a WTO member pursuant to a plurilateral “climate club” or some other plurilateral climate agreement to which that WTO is a party against another WTO member that is not a party to that plurilateral climate agreement will be in compliance with WTO obligations, only to the extent that the requirements of the GATT, the GATS, and other relevant WTO agreements are fulfilled.

#### Policy Option 13

Through a decision by the members of the WTO, provide that:

- a) There is no territorial limitation to Article XX of the GATT, and that therefore WTO members have the legal right to take measures domestically to address environmental harms that occur outside their national territory;
- b) Or, provide, more narrowly, only that there is no territorial limitation to Article XX of the GATT and Article XIV of the GATS for measures taken for climate reasons relating to the amount of carbon used in making traded products.

We note that Article 7.2(c) of the UNFCCC stipulates that the COP shall “facilitate, at the request of two or more Parties, the coordination of measures adopted by them to address climate change and its effects (...).” This is a rather far-reaching provision in that it requires concrete action from the COP to “facilitate” in addition to creating simply legal space for plurilateral action. Moreover, the request by two or more parties to which this provision refers would have to be made to the COP through inclusion of the item on the agenda of a COP, and the COP would then need to actively consider the request (Amerasinghe 2010, 22). We have not discussed the implications of this in depth, but we believe this possible approach is worthy of serious consideration in seeking added flexibility for furthering climate action.

### 3.4. An Agreed Framework for Emissions Trading, Carbon Taxes, Border Measures

Among the fragmented responses to climate change post 2015, we can expect the proliferation of a range of policies to price carbon, including emissions trading, carbon taxes, and possibly trade restrictive border measures. These policies all have relevance for international trade because they affect the relative prices of products based on their respective carbon emissions. In addition, many of them relate to the emergence of climate-related clubs and plurilateral actions, such as in the linking of emissions trading schemes.

Putting a price on carbon is essential to climate change mitigation. But doing so in a largely uncoordinated manner enormously complicates the policy options for preventing

a collision between the trade and climate regimes. It does so especially with respect to the array of trade restrictive “border measures,” which could well be implemented by countries for what will be professed to be climate reasons. Fearful of “carbon leakage” resulting from domestic policies, and of being put at a competitive disadvantage with foreign producers, domestic producers may well demand “carbon tariffs,” “border tax adjustments,” “free allowances,” and other primarily political concessions as the price for their acquiescence to national restrictions on carbon emissions. Such fears may be overstated. Empirical evidence to date suggests that there is less “carbon leakage” than many believe. However, politics being what it is everywhere in the world, many concessions to local political considerations in the form of “border measures” are likely to be made—if only to be assured of securing the votes needed for climate actions.

Against this background, instead of simply counting on an accommodating reading of Article XX as it stands in eventual WTO dispute settlement, the trade system could do more to assure such an outcome. This could be done by clarifying that the relevant provisions of Article XX apply to protection of the world’s climate, for example by an interpretative understanding (Porges and Brewer 2013). Indeed, one of the main concerns in the climate-trade interface is that of unnecessarily restricting trade for climate reasons—a debate that is ongoing in the UNFCCC as well as in the WTO and other trade settings.<sup>6</sup> To this end, we offer the following options.

#### Policy Option 14

Through a decision by the members of the WTO, clarify the relationship between international emissions trading schemes and the WTO so as to:

- a) Ensure that WTO rules explicitly apply to international emissions trading;
- b) Permit importing countries to require importers to purchase emission reduction units under that country’s emissions trading scheme as a condition of importing;
- c) Affirm that grants of exemptions and “free allowances” in emissions trading schemes are actionable subsidies under WTO rules. This could be combined with a time-limited peace clause allowing for a phase-out of existing free allowances so as to avoid challenges in the Dispute Settlement Body.

#### Policy Option 15

Through a decision by the members of the WTO, provide that a carbon tax or any similar tax based on the amount of carbon used in making a product is an indirect tax on a product that is therefore eligible for a “border tax adjustment” under Article II:2(a) of the GATT, either through a charge on an imported product or through a remission on an exported product, and, consequently, is not a violation of the prohibition against excessive taxation of imported products in Article III:2 of the GATT.

### 3.5. Make Use of Subsidies, Standards, Government Procurement, Intellectual Property

A key challenge in addressing climate change is to provide at a minimum a level playing field between clean and fossil energies. Importantly, as we have said, this includes pricing carbon. In addition to putting a price on carbon, it is essential to stop subsidizing it. This should be done by phasing out fossil fuel subsidies. We believe that the WTO has a role to play in this context, because fossil fuel subsidies are likely to affect competition and trade.

Moreover, to address climate change, it will be necessary to stimulate the production and use of low-carbon products. Towards this end, a range of policy instruments are being used by policy-makers, including the use of subsidies, standards, intellectual property rules, and government procurement. In some cases, there is a lack of clarity on what is allowed and what is not, creating a zone of uncertainty that must be addressed. Many options in this category are covered by other E15 groups, in particular the Expert Group on clean energy technologies and the Task Force on subsidies. Below we have chosen to highlight a few climate-specific options for consideration.

#### Policy Option 16

Mandate full disclosure of fossil fuel subsidies under WTO rules, affirm that fossil fuel subsidies are actionable subsidies under those rules, and agree on the gradual phase-out and ultimate prohibition of such subsidies.

#### Policy Option 17

Specify that Article XX of the GATT applies to the Agreement on Subsidies and Countervailing Measures (ASCM), so that subsidies intended to support climate action may deviate from the general obligations.

#### Policy Option 18

Ban “Buy National” government procurement and permit only non-discriminatory purchases of climate-friendly environmental goods and services under the WTO Government Procurement Agreement while encouraging more WTO members to accede to that Agreement. (See the Government Procurement Agreement—GPA.)

#### Policy Option 19

Enhance the clarity of current WTO rules on the permissibility of non-discriminatory environmental standards and technical regulations by encouraging high standards and regulations while barring both *de jure* and *de facto* discrimination. (See Article I and Article III of the GATT and Articles 2.1 and 2.2 of the TBT Agreement.)

#### Policy Option 20

Encourage the conclusion of mutual recognition and harmonization of environmental standards through use and enhancement of existing WTO rules, especially through the further development of international standards. (See Articles 2.6 and 2.7 of the TBT Agreement.)

<sup>6</sup> The recent experience of the European Union attempting to impose unilaterally a carbon cost on international aviation clearly demonstrated how controversial this issue remains worldwide.

#### Policy Option 21

Speed the spread of new green technologies by improving the provisions in WTO intellectual property rules on “green” technology transfer to least-developed and other developing countries. A new WTO working party should be appointed to explore and recommend ways of striking an appropriate balance to meet the needs for both access and innovation. (See Article 66.2 of the Agreement on Trade-Related Aspects of Intellectual Property Rights—TRIPS.)

### 3.6. Foster Sectoral Approaches, Including Maritime Shipping and Aviation

In addressing climate change, where progress among smaller groups of stakeholders on a limited set of issues at a time is more easily within reach than a global, comprehensive deal, it is relevant to also revisit the concept of sectoral deals. Sectoral rules can be the building blocks towards global rules. One of the sectors we have considered is international shipping—a sector with a very clear trade link, and with reasonable abatement opportunities at hand. International maritime shipping produces about 3% of global greenhouse gas emissions. With such emissions expected to double by 2050, the importance of finding a targeted solution is clear. Some progress has already been made by the International Maritime Organization (IMO) towards improving fuel efficiency in international maritime shipping. We offer the following sectoral options.

#### Policy Option 22

Through a decision of the members of the WTO, affirm that climate agreements affecting trade made by certain international organizations such as the IMO and the International Civil Aviation Organization (ICAO) will be upheld in WTO dispute settlement as to WTO members that are parties to those agreements, but not to those WTO members that are not.

#### Policy Option 23

The IMO should set a global target for carbon dioxide emissions in international maritime shipping.

#### Policy Option 24

The IMO or a group of Arctic countries should reach an agreement on addressing black carbon and methane emissions in the Arctic region in particular, by adopting and enforcing performance standards for ships operating in the region.

International aviation accounts for about 2–3% of all global greenhouse gas emissions, and its global warming impact is perhaps twice that amount if water vapour contrails and cirrus cloud effects are included. Carbon emissions from aviation doubled between 1990 and 2010, and could quintuple by 2050. As mentioned, an attempt by the European Union to enhance mitigation in the sector targeted the inclusion of aviation in the Emissions Trading System. However, the international application of the measures was suspended by the EU while awaiting results from ICAO’s consideration of the issues.

Therefore, we suggest that the COP should call for the ICAO to address issues of climate change more urgently than it has done to date. Furthermore, if significant progress is not made by the ICAO to address climate change issues, then the next COP should request the United Nations General Assembly to consider reform and restructuring of the ICAO to ensure that climate change issues are sufficiently addressed.

# 4. Next Steps

The Nairobi trade conference (MC10) and the Paris climate conference (COP21) mark important steps, but many more steps must be taken. The trade regime and the climate regime are moving forward on any number of interrelated issues affecting the intersection of trade and climate change. Above all, we urge all of those who have invested so much effort into the separate successes of COP21 and MC10 simply to communicate. They must come together now, and they must work together now, to explore mutual solutions to prevent a collision between the two regimes, and, further, to foster and facilitate an ongoing cooperation and collaboration between the two regimes. We have offered a number of options we believe worthy of their consideration. Others will offer more. None of the options for dealing with the nexus of trade and climate change will succeed if significant additional efforts are not made by both regimes to work as one on behalf of our overriding global goals for sustainable development.

# References and E15 Papers

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Porges, Amelia, and Thomas L. Brewer. 2013. *Climate Change and a Renewable Energy Scale-up: Responding to Challenges posed to the WTO*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

## Think Pieces

### **E15 Expert Group on Measures to Address Climate Change and the Trade System**

Cottier, Thomas. 2015. *Renewable Energy and Process and Production Methods*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Derwent, Henry. 2015. *What Has Climate to Fear from Trade?* E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Leycegui, Beatriz, and Imanol Ramírez. 2015. *Addressing Climate Change: A WTO Exception to Incorporate Climate Clubs*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Petsonk, Annie, and Nathaniel Keohane. 2015. *Creating a Club of Carbon Markets: Implications of the Trade System*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Victor, David G. 2015. *The Case for Climate Clubs*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

The papers commissioned for the E15 Expert Group on Measures to Address Climate Change and the Trade System can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Current Status and Gap
<b>Maximize the ways trade can address climate change while minimizing conflicts between the trade and climate regimes</b>	
<p>1. Enhance the mutual understanding between the trade and climate regimes through recognizing the legitimacy of each regime and through a greater use of existing fora, such as the Committee on Trade and Environment and the Trade Policy Review Mechanism of the WTO as well as the Subsidiary Body on Scientific and Technological Advice of the UNFCCC, for assessing implications of one regime for the other.</p>	<p><i>Ad hoc</i> discussions have been held in the WTO Committee on Trade and Environment (CTE) on climate-related topics. Some trade-relevant discussions have also been carried out under the UNFCCC response measures forum-SBSTA/SBI. A decision on the continuation of the response measures forum is pending. A more systematic approach is needed.</p>
<p>2. Strengthen the WTO Trade Policy Review Mechanism to include a required assessment of the impact of relevant domestic measures on climate change, and also on efforts to address climate change.</p>	<p>No steps taken. At the 2009 Copenhagen Climate Summit, US President Obama proposed that the WTO Trade Policy Review Mechanism be replicated in a climate governance context, but no concrete steps pursuant to this have been taken within the UNFCCC.</p>
<p>3. Continue to explore the role for a formal and mandatory climate dispute settlement mechanism in the UNFCCC and in other international climate agreements.</p>	<p>A non-paper by Bolivia on a climate tribunal had been submitted in the context of the UNFCCC Ad Hoc Working Group on the Durban Platform for Enhanced Action (ADP). The latest draft text of the Draft agreement and draft decision on workstreams 1 and 2 of the ADP (10 November 2015) includes under Article 11 (Facilitating Implementation and Compliance) an option for the establishment of:</p> <p>An International Tribunal of Climate Justice to address cases of non-compliance with the commitments of developed country Parties on mitigation, adaptation, provision of finance, technology development and transfer, capacity-building, and transparency of action and support, including through the development of an indicative list of consequences, taking into account the cause, type, degree, and frequency of non-compliance.</p> <p>Bracketed text in the Draft Agreement (Article 104) also requests the [IPC][ADP][COP][SBI] to develop the [additional] modalities and procedures for the [effective operation of the Committee] [process] [mechanism] [International Climate Justice Tribunal] [, including the Committee,] referred to in Article 11 of the Agreement, with a view to completing its work on this matter for consideration and adoption by the CMA at its first session.</p> <p>The scope of the text is limited to developed countries and will await an outcome at COP21 in Paris.</p>
<p>4. In the UNFCCC, include an agreed means for measuring, reporting, and verifying measures taken to implement Intended Nationally Determined Contributions (INDCs) that can be used for purposes of identifying “climate measures” in trade and other dispute settlement.</p>	<p>The latest draft text of the Draft agreement and draft decision on workstreams 1 and 2 of the ADP (10 November 2015) provides for a number of options for a review, monitoring and verification. So far the nature, impact, regularity, and other details of the review process remain to be decided at COP21 in Paris. “Climate Measures” are not specifically defined but the draft text provides that further definitions may be required at a later stage in the negotiation process.</p>

Policy Option	Current Status and Gap
<p>5. Have the WTO agree that it will be bound for purposes of WTO dispute settlement by the judgments in any climate dispute settlement mechanism relating to climate compliance under those agreements. Provide that: A national measure taken by WTO Members which is found to be in furtherance of a national climate “contribution” in a climate agreement will be respected in WTO dispute settlement, and that such a measure will be exempt from what would otherwise be that WTO Member’s WTO obligations;</p> <p>Trade sanctions taken by one WTO Member against goods or services of another WTO Member pursuant to the terms of a climate agreement to which both those WTO Members are parties will be considered to be in compliance with WTO obligations.</p>	No steps taken
<p>6. Through a decision or some other legal action by the Members of the WTO, create a legal breathing space by establishing a “peace clause” for climate action. Such a “peace clause” could require WTO Members to wait at least three years before challenging national climate measures or countermeasures that restrict trade or otherwise have trade effects in WTO dispute settlement.</p>	No steps taken
<p>7. Through a common action by the UNFCCC and the WTO, clarify the differences, if any, between the concept of “common but differentiated treatment” in the climate regime and the concept of “special and differential treatment” in the trade regime, and, further, clarify the ways and the extent to which these forms of treatment should be acknowledged in dispute settlement involving trade-related climate measures.</p>	No steps taken
<p><b>Recognize embedded carbon in trade and revisit the concept of like products</b></p>	
<p>8. Initiate a joint effort by the WTO, the UNFCCC, and other relevant international institutions to establish an agreed common international standard for calculating the amount of carbon used in the making of traded products.</p>	No steps taken
<p>9. Agree on a “waiver” from WTO obligations for all trade restrictive “climate measures” that are based on the amount of carbon used in making a product and that are taken in furtherance of and in compliance with a UNFCCC climate agreement or with a plurilateral “climate club.”</p>	No steps taken
<p><b>Foster climate action through enabling the formation of climate clubs and coalitions</b></p>	
<p>10. Members of the WTO should affirm by a decision that climate measures taken pursuant to a climate agreement of the UNFCCC are measures falling within the scope of Article XX of the GATT and of Article XIV of the GATS, and will be entitled to the benefit of those general exceptions to the obligations in the WTO treaty provided they comply in their application with the conditions to those exceptions reiterated in Article 3.5 of the UNFCCC.</p>	No steps taken

Policy Option	Current Status and Gap
<p>11. Members of the WTO should agree on a set of circumstances in which there would be a presumption in favour of granting a waiver for a climate-related “club” organized outside the framework of the WTO to become a “plurilateral” agreement under the WTO treaty. Members of the plurilateral could commit to a set of rules on climate change that would be binding solely on them and would be fully enforceable in WTO dispute settlement.</p>	No steps taken
<p>12. Through a decision by the Members of the WTO: Affirm that an agreement by a climate “club” to provide “WTO-plus” trade benefits over and above those due under the WTO treaty to WTO Members that are members of that “club,” and not to those WTO Members that are not “club” members, is permissible under WTO rules; Provide that trade sanctions taken by a WTO Member pursuant to a plurilateral “climate club” or some other plurilateral climate agreement to which that WTO is a party against another WTO Member that is not a party to that plurilateral climate agreement will be in compliance with WTO obligations, only to the extent that the requirements of the GATT, the GATS, and other relevant WTO agreements are fulfilled.</p>	No steps taken
<p>13. Through a decision by the Members of the WTO, provide that: There is no territorial limitation to Article XX of the GATT, and that therefore WTO Members have the legal right to take measures domestically to address environmental harms that occur outside their national territory; Or, provide, more narrowly, only that there is no territorial limitation to Article XX of the GATT and Article XIV of the GATS for measures taken for climate reasons relating to the amount of carbon used in making traded products.</p>	No steps taken
<b>An agreed framework for emissions trading, carbon taxes, border measures</b>	
<p>14. Through a decision by the Members of the WTO, clarify the relationship between international emissions trading schemes and the WTO so as to: Ensure that WTO rules explicitly apply to international emissions trading; Permit importing countries to require importers to purchase emission reduction units under that country’s emissions trading scheme as a condition of importing; Affirm that grants of exemptions and “free allowances” in emissions trading schemes are actionable subsidies under WTO rules. This could be combined with a time-limited peace clause allowing for a phase-out of existing free allowances so as to avoid challenges in the Dispute Settlement Body.</p>	No steps taken but a more ambitious mandate on the lines of Para 31 (i) of the Doha Declaration (Clarifying the relationship between specific trade obligations in multilateral environmental agreements (MEAs) and WTO rules) could be envisaged in the future.
<p>15. Through a decision by the Members of the WTO, provide that a carbon tax or any similar tax based on the amount of carbon used in making a product is an indirect tax on a product that is therefore eligible for a “border tax adjustment” under Article II:2(a) of the GATT, either through a charge on an imported product or through a remission on an exported product, and, consequently, is not a violation of the prohibition against excessive taxation of imported products in Article III:2 of the GATT.</p>	No steps taken

**Make use of subsidies, standards, government procurement, intellectual property**

16. Mandate full disclosure of fossil fuel subsidies under WTO rules, affirm that fossil fuel subsidies are actionable subsidies under those rules, and agree on the gradual phase-out and ultimate prohibition of such subsidies.

No steps taken

17. Specify that article XX of the GATT applies to the Agreement on Subsidies and Countervailing Measures (ASCM), so that subsidies intended to support climate action may deviate from the general obligations.

Para 28 of the Doha Ministerial Declaration calls for negotiations aimed “at clarifying and improving disciplines under the Agreements on Implementation of Article VI of the GATT 1994 and on Subsidies and Countervailing Measures, while preserving the basic concepts, principles and effectiveness of these Agreements and their instruments and objectives, and taking into account the needs of developing and least-developed participants.” However this would depend on the eventual outcome of the Doha Round.

18. Ban “Buy National” government procurement and permit only non-discriminatory purchases of climate-friendly environmental goods and services under the WTO Government Procurement Agreement while encouraging more WTO Members to accede to that Agreement.

No steps taken

19. Enhance the clarity of current WTO rules on the permissibility of non-discriminatory environmental standards and technical regulations by encouraging high standards and regulations while barring both *de jure* and *de facto* discrimination. (See Article I and Article III of the GATT and Articles 2.1 and 2.2 of the TBT Agreement.)

No steps taken

20. Encourage the conclusion of mutual recognition and harmonization of environmental standards through use and enhancement of existing WTO rules, especially through the further development of international standards. (See Articles 2.6 and 2.7 of the TBT Agreement.)

The use of IEC and ISO International Standards is deemed consistent with the obligations of countries that are members of the WTO and both have adopted the WTO TBT Code of Good Practice for preparation, adoption and application of standards.

The IEC and ISO also developed various environment-related standards including in the following areas of climate mitigation: (i) Monitoring and measurement of greenhouse gas emissions (ii) Measuring the carbon footprint of networks and products (iii) Designing and building energy efficient homes and workplaces (iv) Benchmarking for good practices including environmental and energy efficiency labelling (v) Promoting good practice for environmental management and design, and for energy management (vi) Disseminating innovative technologies that promise to help reduce the effects of climate change (vii) Fostering the introduction of new energy-efficient technologies and services.

The IEC has a dedicated advisory committee on environmental aspects (ACEA). The ACEA coordinates and guides the IEC’s efforts to ensure that IEC International Standards don’t include specifications which would harm the environment. The IEC also has several technical committees working in the field of renewable energies, looking at areas such as hydropower, ocean power, solar energy, wind turbines, and fuel cell technologies.

In addition a number of bilateral mutual recognition agreements (MRAs) has been signed between countries although most of these have to do with conformity assessment and very few presume equivalence of standards. Many of the standards that are deemed equivalent have to do with technical specifications for products medical or electrical equipment and are not specifically related to the environment.

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**Policy Option**

21. Speed the spread of new green technologies by improving the provisions in WTO intellectual property rules on “green” technology transfer to least-developed and other developing countries. A new WTO working party should be appointed to explore and recommend ways of striking an appropriate balance to meet the needs for both access and innovation. (See Article 66.2 of the Agreement on Trade Related Aspects of Intellectual Property Rights—TRIPS.)

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**Current Status and Gap**

Ecuador submitted a proposal (IPC/W/585) at WTO TRIPS Council meeting on 11-12 June 2013 proposing a number of solutions to facilitate the transfer to developing countries of environmentally sound technologies that might be hindered by intellectual property rights. These included a reaffirmation of flexibilities in the TRIPS that would be available for green technologies, a review of a review of Article 31 of TRIPS, on “Other Use Without Authorization of the Right Holder,” and an evaluation of Article 33 of the TRIPS on the term of protection. The initial proposal has yet to find traction among a number of other WTO members. Discussions on the topic will continue in the context of the TRIPS Council.

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**Foster sectoral approaches, including maritime shipping and aviation**

22. Through a decision of the Members of the WTO, affirm that climate agreements affecting trade made by certain international organizations such as the International Maritime Organization (IMO) and the International Civil Aviation Organization (ICAO) will be upheld in WTO dispute settlement as to WTO Members that are parties to those agreements, but not to those WTO Members that are not.

No steps taken

23. The IMO should set a global target for carbon dioxide emissions in international maritime shipping.

More Can be Done: The IMO’s Marine Environment Protection Committee (MEPC) has so far not set a GHG emissions reduction target for the shipping industry. The committee pledged instead to continue analytic work in this area. This includes efforts on mandatory measures adopted in 2011 and effective from 2013 on improving the fuel efficiency of new and existing ships. The fuel efficiency objectives of these measures are relevant because they can reduce GHG as well as black carbon emissions. The fuel efficiency regulations are mandatory, tangible, in force—in the form of amendments to the International Convention for the Prevention of Pollution from Ships (MARPOL)—and will evolve over time.

24. The IMO or a group of Arctic countries should reach an agreement on addressing black carbon and methane emissions in the Arctic region in particular, by adopting and enforcing performance standards for ships operating in the region.

More Can be Done: The Arctic Council has approved an Arctic Council Framework for Action titled “Enhanced Black Carbon and Methane Emissions Reductions.”

In this the eight member states commit to: “Develop and improve emission inventories and emission projections for black carbon using, where possible, relevant guidelines from the Convention on Long-Range Transboundary Air Pollution (CLRTAP) and improve the quality and transparency of information related to emissions of black carbon,” and “Enhance expertise on the development of black carbon inventories, including estimation methodologies and emissions measurements, by working jointly through the Arctic Council and other appropriate bodies...”

The IMO International Code for Ships Operating in Polar Waters, addresses safety and environmental issues for shipping in hazardous and environmentally vulnerable waters of the Arctic and Antarctic regions. The code will be mandatory through amendments under both MARPOL and the International Convention for the Safety of Life at Sea (SOLAS). It will enter into force on 1 January 2017. Black carbon has however not been included in the code. Perhaps in the future the code might be used to serve as a legal basis for expanding IMO regulations to mitigate Arctic black carbon. The IMO’s fuel-efficiency regulations will also contribute towards reducing black carbon emissions.

# Annex 1: Summary Table of Main Policy Options

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The experts all participated in their personal capacity. The views and recommendations expressed in the policy options paper are not attributable to any institution with which members of the E15 Expert Group are associated.



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# Competition Policy and Trade in the Global Economy: Towards an Integrated Approach

Policy Options Paper



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# Competition Policy and Trade in the Global Economy: Towards an Integrated Approach

Eduardo Pérez Motta

on behalf of the E15 Expert Group on Competition Policy and the Trade System

January 2016

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Competition Policy and the Trade System. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15 Initiative and authored by group members. Eduardo Pérez Motta was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

### E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:  
[www.e15initiative.org](http://www.e15initiative.org)

# Abstract

Competition law and policy are essential elements of the global framework for addressing anticompetitive arrangements that thwart development and reduce the welfare of citizens. The importance of such law and policy is now recognized across developed and developing countries alike. Competition law, in particular, deters arrangements such as cartels, abuses of dominant position, and mergers that, left unrestrained, block competition on the merits. Despite the very significant progress towards promoting international cooperation and convergence in competition policy that has been made mainly by the International Competition Network (ICN), an informal network of competition authorities, major future challenges remain as globalization goes further and deeper. This leads the present paper to reflect on the need for additional coordination mechanisms to address the challenges of an increasingly globalized and networked economy. In recognition of the fundamental complementarity of competition and trade policy, multiple initiatives have been taken at the international level to attempt to formalize their interrelationships and better harness related synergies. To date, none of these initiatives has resulted in a binding framework that ensures a better application of competition policy in relation to trade and investment. In the context

of this incomplete institutional and policy infrastructure, the paper puts forward a set of policy options with the objective of intensifying international convergence and injecting competition into international trade. Many of these recommendations can be implemented through existing mechanisms and institutions. They include: (i) multidimensional awareness raising concerning the role of competition policy; (ii) practical steps aimed at enhancing cooperation in the implementation of competition policy at the international level; (iii) the progressive introduction of international dispute resolution and appeal mechanisms; (iv) the promotion of convergence and best practices in competition regimes through peer reviews; (v) the enhanced engagement of national competition authorities in assessing and advising on the implementation of trade measures; (vi) the review of rules on competitive neutrality as a tool to address the role of state-owned enterprises; and (vii) efforts to broaden the application of innovative approaches to the trade and competition interface in free trade agreements. The paper advocates an incremental path to reform and emphasizes that the efforts to be undertaken in the international competition policy arena should build on the important work already being conducted on related issues by organizations such as the ICN, the OECD, and UNCTAD.

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Abbreviations	
FDI	foreign direct investment
FTA	free trade agreement
GATT	General Agreement on Tariffs and Trade
GVC	global value chains
ICN	International Competition Network
MNE	multinational enterprise
OECD	Organisation for Economic Co-operation and Development
SME	small and medium-sized enterprise
SOE	state-owned enterprise
SPS	sanitary and phytosanitary
TBT	technical barrier to trade
TPP	Trans-Pacific Partnership
UNCTAD	United Nations Conference on Trade and Development
USTR	United States Trade Representative
WTO	World Trade Organization

# Executive Summary

Globalization has become a reality, as manifested by ever-larger flows of transnational trade and investment. At the same time, the latest available figures reflect downward corrections of trade growth forecasts. Economists suggest that this may be due not only to the lingering effects of the 2008 financial and economic crisis, but also to structural changes that have resulted in lower elasticity of trade with respect to general economic growth. Against this background, some key questions underlying the policy options paper are the following: what can be done to renew sustained growth in world trade and to enhance the contribution of trade to economic growth and prosperity? Is the policy and institutional framework for the global economy incomplete?

Competition policy, comprising both competition (antitrust) law enforcement and competition advocacy work, is a central element of the necessary framework for inclusive liberalization. Competition enforcement provides an essential tool for countering cartels, abuses of a dominant position, and anticompetitive mergers that otherwise undermine the purchasing power of citizens, block competitive opportunities, and impede development. It is key to ensuring that state-owned or mandated enterprises operate in ways that promote welfare globally and do not place non-state affiliated enterprises at an unfair disadvantage. Finally, as elaborated in the paper, competition policy and competition analysis are essential to ensure that international trade and global value chains operate in ways that are inclusive and open with respect to participation by all competitive suppliers.

Despite very significant efforts aimed at promoting international cooperation in competition law enforcement, especially during the past two decades, competition policy is as yet only partially adapted to the challenges associated with today's globalized economy. Jurisdictional gaps remain to be filled. While much useful work has been done by organizations such as the International Competition Network (ICN), the Organisation for Economic Co-operation and Development (OECD), and United Nations Conference on Trade and Development (UNCTAD) to promote international cooperation and the voluntary adoption of sound enforcement practices at the national level, the world today lacks binding mechanisms to ensure transparent and non-discriminatory application of competition law by all countries. In the absence of such mechanisms, there is a risk that competition law enforcement can itself be employed as a tool of discrimination or market exclusion, contrary to the values it is intended to promote.

The paper outlines proposals to address these challenges. It builds on discussions that took place over a one-year period in the E15 Expert Group on Competition Policy and the Trade System, jointly convened by ICTSD and the World Economic Forum with the support of Bruegel, as well as think pieces authored by members of the Expert Group.

## Background

Globalization has specific implications for competition law and policy. The mounting cross-border fluidity of economic activity has been reflected in the growing number of competition law cases with an international dimension. The fact that individual commercial transactions or conduct may be subject to overlapping scrutiny by competition agencies in multiple jurisdictions, sometimes with conflicting results, imply a need for examination of the possibilities for greater coordination of enforcement standards and remedies in competition law cases with transnational effects.

Supranational trade frameworks have, in the past, provided an effective conduit to facilitate the growth of cross-border trade flows. In many instances, however, these frameworks still entail gaps, flexibilities, and second best approaches to trade regulation (and its enforcement) that allow for a certain degree of protectionism to resume. It is thus crucial to work on those areas of trade regulation where gaps persist. In the context of a slow post-crisis global economic recovery, renewed attempts to exploit the imperfections of the international trade regime may be expected and it will be important for policy-makers to consider competition principles (market efficiency and consumer interest) in policy design and implementation.

Moreover, state-owned enterprises (SOEs) have emerged as a new influential player on the international scene. Like many non-state-owned companies, SOEs have also grown beyond national borders and expanded their activities globally. The increasing presence of public enterprises in the world economy presents particular challenges for competition, trade, and investment policies. The establishment of a level playing field between SOEs and private businesses is a core challenge for international trade and investment policy in the 21<sup>st</sup> century. A key dimension of the framework to be developed will involve ensuring the full application of national competition laws to SOEs that compete with non-state-owned actors except as specifically justified by narrowly defined criteria.

Given the recent evolution of the global economic landscape it has become increasingly important that the competition and trade policy communities enter into a constructive strategic dialogue to ensure that anticompetitive and trade restrictive measures do not negate the growth and efficiency gains of the past decades. In order to realize the full potential of a globalized economy in promoting sustainable growth and development, a re-evaluation of the current interaction between the domains of trade and competition policy is warranted.

## Policy Options

The paper puts forward a set of proposals aiming to facilitate the use of competition law and enforcement to better harness the benefits brought about by trade liberalization.

First, to prevent that these benefits be negated by increasingly sophisticated anticompetitive practices and arrangements with an international dimension, a re-examination of the application and design of competition policy itself may be required. The paper explores reforms that should be undertaken in the competition policy community to decrease the risk of inconsistent, inappropriate, or abusive use and enforcement of competition policy that could have negative impacts on trade and investment flows. Four measures are proposed to incrementally optimize the international competition ecosystem: multidimensional awareness-raising; enhanced coordination and collaboration at the supranational level; the introduction of an international dispute resolution and appeals mechanism in the context of bilateral and regional free trade agreements (FTAs); and the promotion of convergence in competition regimes through enhanced peer reviews.

Second, the paper examines the importance of competition policy considerations in the adoption and assessment of trade rules and measures. It suggests that renewed attention directed at the interface with international trade policy is necessary. And, rather than focus on preventing anticompetitive measures that may undermine the trade agenda, the positive role the competition policy community can play in optimizing current international trade frameworks should be enhanced. To this end, it elaborates on how competition law could be used to counterbalance the negative influence of domestic interest groups on the trade and investment policies of their governments. Two essential dimensions of this strengthening of the role of competition policy are put forward: greater empowerment and engagement of national competition agencies in the decision-making and implementation of existing flexibilities in trade rules; and an assessment of the current regulatory framework for state-owned enterprises with the elaboration of key principles and rules on competitive neutrality.

Third, recommendations are put forward for harnessing the power of FTAs and dispersing more widely the most useful and innovative approaches to the interface between trade and competition policy. In addition to fostering further cooperation and convergence in enforcement matters, future or presently negotiated trade and investment arrangements could act as a vehicle for incremental harmonization of competition laws and practices in the absence of an international agreement on these issues. Particular attention is paid to approaches reflected in the recently concluded Trans-Pacific Partnership Agreement. In addition, the development of a model competition chapter, developed by the ICN with technical advice provided by the OECD and UNCTAD, for inclusion in FTAs would greatly facilitate the process of formally strengthening the interface between trade and competition policy.

## Next Steps

It is advisable that competition authorities strategically prioritize the implementation of the proposals outlined in the paper. Given their limited resources, they should place particular emphasis on choosing those options that maximize the impact of their interventions and help enhance the effectiveness and efficiency of their actions.

The efforts to be undertaken in the international competition policy arena should build on the very important work already being conducted on related issues by organizations such as the ICN, OECD and UNCTAD. A practical and incremental approach to the optimization of competition law and policy vis-à-vis the global trading system is envisioned. The willing participation of leading competition agencies and other advocates of progressive competition policy is vital. In this way, it is believed that the framework to emerge would make an essential contribution to a more inclusive and balanced globalization underpinning world prosperity and development in the decades to come.

# 1. Introduction

The world economy today faces an imposing array of challenges—challenges differing, in many ways, from those that shaped the prevailing architecture of the global trading system. Globalization has become a reality, as manifested by ever-larger flows of transnational trade and investment. Digital communication networks that span the world underpin global trade and investment. And, increasingly, participation in global value chains (GVCs) has become a fulcrum of success for businesses in developing, emerging, and developed economies alike.

At the same time, the latest available figures reflect downward corrections of trade growth forecasts. Economists suggest that this may be due not only to the lingering effects of the 2008 financial and economic crisis, but also to structural changes that have resulted in lower elasticity of trade with respect to general economic growth.<sup>1</sup> In this context, some key questions underlying this paper are the following: what can be done to renew sustained growth in world trade and to enhance the contribution of trade to economic growth and prosperity? Is the policy and institutional framework for the global economy incomplete?

Without denying that the answers to these questions may be complex and multifold, this paper starts from the premise that, to date, the institutional and policy infrastructure to support and ensure the success and inclusiveness of a truly global economy is incomplete. Traditional trade barriers (tariffs and quotas) have been substantially reduced through the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), and the WTO's Dispute Settlement Understanding has established a robust mechanism for resolving many types of transnational trade conflicts that previously could fester indefinitely. Bilateral/regional trade agreements—including, most recently, the Trans-Pacific Partnership (TPP)—and a plethora of bilateral investment treaties have promoted further liberalization and have charted pathways that the global economy and multilateral institutions could eventually follow. Plurilateral liberalization efforts relating to issues and sectors such as government procurement and information technology are gathering steam. Yet, sustained efforts to implement enforceable multilateral frameworks for investment and competition policy covering more than select groups of individual economies have foundered, and currently are not being actively pursued in relevant institutions. Many national

economies have yet to recover their pre-crisis dynamism, and the possibility of renewed protectionism cannot be ruled out. At the very least, renewed efforts are needed to ensure market openness and inclusivity that will benefit all members of the global community.

Competition policy, comprising both competition (antitrust) law enforcement and competition advocacy work, is a central element of the necessary framework for inclusive liberalization and growth.<sup>2</sup> Competition enforcement provides an essential tool for countering cartels, abuses of a dominant position, and anticompetitive mergers that otherwise undermine the purchasing power of citizens, block competitive opportunities on the merits, and impede development. It is key to ensuring that state-owned or mandated enterprises operate in ways that promote welfare globally and do not place non-state affiliated enterprises at an unfair disadvantage. Finally, as will be elaborated in this paper, competition policy and competition analysis are essential to ensure that international trade and global value chains operate in ways that are inclusive and open with respect to participation by all competitive suppliers.

Despite very significant efforts aimed at promoting international cooperation in competition law enforcement, especially during the past two decades, competition policy, which initially emerged as a national (domestic) economic policy, is as yet only partially adapted to the scope, reach, and challenges associated with today's globalized economy. Jurisdictional gaps relating to practices such as export cartels remain to be filled. Additionally, while there has been a proliferation of competition laws across the developing world during the past fifteen years—to the extent that more than 120 WTO member governments now implement such laws—the strength of competition policy institutions is far from even across countries. And, while much useful work has been done by organizations such as the International Competition Network (ICN), the Organisation for Economic Co-operation and Development (OECD), and United Nations Conference on Trade and Development (UNCTAD) to promote international cooperation and the voluntary adoption of sound enforcement practices at the national level, the world today lacks binding mechanisms to ensure transparent and non-discriminatory application of competition law by all countries. In the absence of such mechanisms, there is a risk that competition

<sup>1</sup> For a useful summary, see for example Rajadhyaksha (2015).

<sup>2</sup> The policy options paper produced by the E15 Task Force on Investment Policy provides in-depth analysis and recommendations concerning the governance of international investment. The paper can be referred to in the present series.

law enforcement can itself be employed as a tool of discrimination or market exclusion, contrary to the values it is intended to promote.

The present policy options paper explores and outlines proposals to address these challenges. It builds on formal and informal discussions that took place over a one-year period in the E15 Expert Group on Competition Policy and the Trade System, jointly convened by ICTSD and the World Economic Forum with the support of Bruegel, as well as on an overview paper and think pieces that were authored by members of the Group.<sup>3</sup> The policy options paper recognizes that the work to be done in the international competition policy arena can and should build on the important efforts already being undertaken on related issues by organizations such as the ICN, the OECD, and UNCTAD. Moreover, not all elements needed to optimize the current international competition policy landscape will necessarily be developed in a particular sequence. A practical and incremental approach to the optimization of competition law and policy vis-à-vis the global trading system is envisioned. The willing participation of national competition authorities and other advocates in the refining of relevant proposals is essential. It is only through such an inclusive and open-ended approach that a global competition policy framework appropriate to the needs and challenges of today's economy can be developed.

<sup>3</sup> The papers commissioned for the E15 Expert Group on Competition Policy are all referenced below.

# 2. A Trade and Competition Agenda for the Global Economy: Scoping the Need

## 2.1. A Truly Globalized Economy

Today, companies and policy-makers alike find themselves in a truly global economy. Trade flows have grown in an unprecedented way alongside a sharp increase in foreign investment. Since the 1990s, world merchandise trade has risen more than 500%. According to OECD (2014) estimates, total foreign direct investment (FDI) expanded more than four times between 1990 and 2012.

The expansion of trade and investment flows demonstrates that countries around the world have embraced trade liberalization, opening up their borders to foreign competitors—albeit to different degrees. Barriers to trade and foreign investment have declined in developed and developing economies alike. A large number of companies have embraced GVCs as their core mode of product and service delivery. This has facilitated a process of production which is unbundled into different steps located across various countries, intensifying the interconnection of national economies and rendering ineffective certain traditional approaches to the regulation of markets.

According to the OECD, the top 300 global companies—with sales over US\$1 billion—have 51% of component manufacturing, 47% of final assembly, 46% of warehousing, 43% of customer service, and 39% of product development taking place outside of their home country. Multinational enterprises (MNEs) have become global players and in their search for the best possible conditions, they have distributed their production and distribution activities worldwide (Eden 2015). In that process, small and medium-sized enterprises (SMEs) all over the world have integrated into global chains when serving MNEs as suppliers, distributors, and retailers, and are now important competitors at a global level.

Globalization of the world economy has resulted in enhanced competition and significant improvements in consumer welfare across many countries. Growing trade flows have imposed competitive pressures on domestic product and service markets in most developed and emerging economies, resulting in lower prices, to the benefit of local consumers, and the stimulation of efficiency and innovation among local enterprises.<sup>4</sup> Still, globalization has not negated the need for governance mechanisms to ensure market openness and address market failures, including those resulting from anticompetitive conduct.

Indeed, globalization has specific implications for competition law and policy.<sup>5</sup> The mounting cross-border fluidity of economic activity has been reflected in the growing number of competition law cases with an international dimension. In the recent past, over 90% of fines secured by the US competition enforcement authorities in relation to cartels have concerned arrangements that are international in scope. Similarly, in the European Union, the number of antitrust cases involving a participant from outside of the Union has grown by more than 450% since 1990. Simultaneously, the number of mergers and acquisitions entailing a cross-border dimension has increased by about 250-350% (Capobianco et al. 2015). These developments, and the fact that individual commercial transactions or conduct may be subject to overlapping scrutiny by competition agencies in multiple jurisdictions, sometimes with conflicting results, imply a need for examination of the possibilities for greater coordination of enforcement standards and remedies in competition law cases with transnational effects.

<sup>4</sup> There are different approaches to innovation. From the competition perspective, there is evidence that greater competition can drive innovation and enhance productivity. The protection of intellectual property is another mechanism to promote innovation. For further development on this approach, the tensions and similarities that might exist between intellectual property and competition, see Santa Cruz Scantlebury and Trivelli (2015).

<sup>5</sup> Competition law, in particular, provides a vital safeguard against anticompetitive arrangements and practices such as cartels, abuses of dominant position and mergers that limit competition and thereby reduce economic welfare in developed and developing economies alike. The broader term “competition policy” encompasses, in addition to competition law, other measures that governments take to promote healthy competition in markets. These include pro-competitive regulatory regimes governing essential facilities and “competition advocacy” work by competition agencies aimed at removing unnecessary structural or regulatory barriers to competition.

## 2.2. The Lingering Effects of the Economic Crisis

The global economic crisis has had a profound impact on the trade, economic, and policy environment firms operate in today. We have already noted a sharp cyclical decline in trade. Recent trade data show that international trade flows are recovering from the crisis, albeit more slowly than many would desire. An October 2015 update to the Financial Times/Brookings Institute TIGER (Tracking Indexes for the Global Economic Recovery) reports as follows. “The world economy is beset by a dangerous combination of divergent growth patterns, deficient demand, and deflationary risks. While growth prospects for the advanced economies have improved, emerging market economies are now leading the world economy into a slump” (Prasad and Foda 2015). The latest figures indicate that trade growth is expected to reach only about half of its pre-crisis levels in 2015, and, as indicated in introduction, economists suggest that this may partly be due to more structural changes that have resulted in lower elasticity of trade with respect to general economic growth.

The slow and unequal recovery from the crisis, especially combined with the lower elasticity of trade, has heightened the importance of the global frameworks for trade, investment, and competition. On the one hand, it will be crucial for countries to adopt necessary trade policy measures in order for trade to reach higher growth levels, as trade would assuredly serve to promote renewed economic growth for many countries and businesses worldwide. This may well, and should, include investment and competition frameworks. Current supranational trade frameworks have, in the past, provided an effective conduit to facilitate the growth of cross-border trade flows. On the other hand, in many instances, these frameworks and associated regulations still entail gaps, flexibilities, and second best approaches to trade regulation (and its enforcement) that allow for a certain degree of protectionism to resume and prevent trade flows from reaching maximum levels. Research has shown that existing trade rules have not fully prevented WTO members from taking trade-protectionist measures as a reaction to the economic crisis (Aggarwal and Evenett 2014).

It will thus be crucial to work on those areas of trade regulation where gaps, flexibilities, and second best approaches persist. Indeed, in the context of a slow post-crisis global economic recovery as well as heightened geopolitical tensions, renewed attempts to exploit the imperfections of the international trade regime may be expected.

A further issue of concern is that when making such policy decisions with a profound impact on international trade and investment, governments tend not to consider competition principles in the evaluation of their decisions and the impact these might have. In other words, market efficiency and consumer interest are not part of the evaluation that authorities usually consider. Among the areas where protectionist actions may be taken without regard to competition policy considerations—facilitated by

flexibilities in the international trading system—are the use of sanitary and phytosanitary (SPS) standards and technical barriers to trade (TBTs); FDI restrictions; barriers to external competitors in government procurement; anticompetitive services regulation; trade defence mechanisms; and the use of margins between applied and bound tariffs. These may therefore be important areas to look at in order to ensure sustainable trade growth.

## 2.3. The Role of State-Owned Enterprises in the Global Economy

State-owned enterprises have been part of the landscape of a number of nations for many years. Only recently have nations come to understand that these enterprises, with their many inherited privileges, are blocking competition and harming their own markets (Fox and Healey 2014). In recent years, state-owned enterprises (SOEs) have emerged as a new influential player on the international scene to be reckoned with. Like many non-state-owned companies, SOEs have also grown beyond national borders and expanded their activities globally. Currently, the value of their sales represents about 19% of the value of global flows of goods and services (Kowalski et al. 2013). According to the OECD, 14% of the largest companies in the world are SOEs distributed across 37 countries. China, India, Russia, the United Arab Emirates, and Malaysia are the countries where the largest SOEs continue to be located.

Additionally, it is noteworthy that many SOEs are involved in the provision of services or in extractive industries and are found in strategic sectors such as telecommunications, financial services, and public utilities. For example, SOEs operating in the sectors of land transport, transport via pipelines, and air transport generate 21% of world services trade (OECD Secretariat 2015). In the manufacturing sectors, SOEs account for more than 60% of world merchandise trade.

The increasing presence of public enterprises in the world economy presents particular challenges for competition, trade, and investment policies. Private businesses, and even public companies from third countries, often experience an uneven playing field given the advantages that domestic SOEs may have in tax treatment, financing, and regulatory application (Capobianco and Christiansen 2011). This discrimination disadvantages meritorious competition, creates market uncertainty, and can adversely affect international flows of trade and investment.

Furthermore, SOEs may have greater ability and/or incentives than private businesses to engage in anticompetitive conduct, as they usually have an important market share, allowing them to behave abusively or more easily engage in anticompetitive mergers and acquisitions. In addition, in many jurisdictions they enjoy competition-law exceptions that further distort the ability of domestic and international firms to effectively compete with these enterprises on their domestic and, increasingly, international markets. As such, the establishment of a level playing field between SOEs and private businesses is a core

challenge for international trade and investment policy in the 21<sup>st</sup> century.<sup>6</sup> A key dimension of the framework to be developed will involve ensuring the full application of national competition laws to SOEs that compete with non-state-owned actors except as specifically justified by narrowly defined criteria.

#### **2.4. Trade and Competition Policies as Vehicles of Inclusive Globalization**

Given the recent evolution of the global economic landscape it has become increasingly important that the competition and trade policy communities enter into a constructive strategic dialogue to ensure that anticompetitive and trade restrictive measures do not negate the growth and efficiency gains of the past decades. At the same time, it is crucial that the expertise gained by the competition policy community in many countries over the past decade or so contributes even more powerfully to sustainable trade growth. It is imperative that the benefits of globalization and profound technological change are not inappropriately captured by narrow economic interests but shared as inclusively as possible. An inclusive globalization is one where competitive markets spread the benefits across all stakeholders in developed and emerging countries alike. Competition policy is the tool designed to achieve this goal.

In order to realize the full potential of a globalized economy in promoting sustainable growth, development, and broad-based advances in welfare, a re-evaluation of the current interaction between the domains of trade and competition policy is warranted. In the following section, the paper puts forward a set of proposals aiming to facilitate the use of competition law and enforcement to better harness the benefits brought about by trade liberalization.

First, to prevent that these benefits be negated by increasingly sophisticated anticompetitive practices and arrangements with an international dimension, a re-examination of the application and design of competition policy itself may be required. The paper will explore reforms that should be undertaken in the competition policy community to decrease the risk of inconsistent, inappropriate, or abusive use and enforcement of competition policy that could have negative impacts on trade and investment flows. Four related measures are proposed to incrementally optimize the international competition ecosystem: multidimensional awareness-raising; enhanced coordination and collaboration at the supranational level; the introduction of an international dispute resolution and appeals mechanism—when countries and national competition authorities are ready in the context of bilateral and regional free trade agreements (FTAs); and the promotion of convergence in competition regimes through enhanced peer reviews.

The paper will further examine the importance of competition policy considerations in the adoption and assessment of trade rules and measures. To this end, it will elaborate on how competition law could be used to counterbalance, with consumer interest in mind, the negative influence of domestic interest groups on the trade and investment policies of their governments. Two essential dimensions of this strengthening of the role of competition policy are put forward: greater empowerment and engagement of national competition agencies in both the decision-making and the implementation of existing flexibilities in trade rules; and the development of rules on competitive neutrality. Additionally, proposals are made for harnessing the power of FTAs and dispersing more widely the most useful and innovative approaches to the interface between trade and competition policy. Particular attention is paid to approaches reflected in the recently concluded Trans-Pacific Partnership Agreement.

<sup>6</sup> The Trans-Pacific Partnership Agreement will reportedly contain important disciplines on the role of SOEs among member countries (see discussion below).

# 3. Policy Options for a More Integrated Approach

## 3.1. Improving the International Competition Ecosystem to Reinforce the International Trade Agenda

Competition law and policy are essential elements of the global framework for addressing anticompetitive arrangements that thwart development and reduce the welfare of citizens. The importance of such law and policy is now recognized across developed and developing countries alike. Competition law, in particular, deters arrangements such as cartels, abuses of dominant position, and mergers that, left unrestrained, reduce output and raise substantially the prices of goods and services, and otherwise block competition on the merits. Much evidence shows that the harmful effects of these practices may be even greater in developing and transition economies than they are in developed economies, due to the general thinness of markets and resultant lack of consumer choice (Levenstein and Suslow 2006).

Competition law—also referred to in some jurisdictions as “antitrust”—is not the only tool that governments have at their disposal to mitigate the impact of anticompetitive practices. Many or most jurisdictions also employ pro-competitive sectoral regulatory regimes to ensure access to essential facilities. Moreover, competition agencies and other advisory bodies may undertake “advocacy” work aimed at removing unnecessary structural or regulatory barriers to competition. These additional tools—sometimes referred to under the wider rubric of “competition policy”—comprise a further dimension of the measures available to governments to ensure that markets function competitively, in the interest of citizens. As will be seen, both competition law and competition policy can be employed in ways that complement international trade policy to better ensure that globalization works to the advantage of citizens.

The number of national competition agencies has grown significantly over the past two decades, just as the economic interconnectedness of countries worldwide has risen. By 2013, the number of jurisdictions with competition law reached 127, with the number of enforcing competition authorities growing to 120 (Capobianco et al. 2015). Global value chains mean that businesses often operate across borders. Consequently, many competition cases today have an international dimension, in which multiple authorities investigate the same matter. At the same time, a harmonized multilateral framework for competition policy is lacking.

Overall, this means that the risk of inconsistency of antitrust decisions with a negative impact on trade and investment flows has also risen. The mere fact of having more competition authorities in different countries, even if they were to have identical laws and procedures, escalates the risk of inconsistent decisions. This risk has been significantly reduced by the impressive and growing convergence of competition laws, as well as major cooperation between national competition authorities, to which the ICN has greatly contributed. However, the potential for conflicting outcomes of two (or more) competition authorities reached in investigating the same antitrust case remains latent due to a variety of reasons. These include:

1. The objectives—or other provisions—of the laws the two authorities are enforcing differ;<sup>7</sup> or
2. The two sets of decision-makers simply come to different views on the case, even when the legal framework and the market are the same.

Such a system imposes large costs on companies and the public sector alike. Firstly, there is the additional expense involved for firms in complying with multiple parallel investigations, and for competition authorities in running them. Secondly, heterogeneity of competition laws potentially creates significant costs, either from complexity, as businesses must adopt different practices in different jurisdictions, or from spillovers when businesses adopt practices globally in response to concerns from only one jurisdiction. Finally, businesses will seek to avoid competition enforcement actions. In a world with many competition authorities they might tailor their activities to comply with the most restrictive regime.

Costs could emerge even if all jurisdictions are applying the same principles, or even the same procedures, sometimes as a simple coordination failure. However, the costs will be significantly greater if some major jurisdictions apply competition law to pursue goals other than consumer welfare, market efficiency, or are prepared to accommodate protectionist lobbying from their own businesses or governments.

Nowadays, some competition law frameworks entail goals and mandates stretching beyond unambiguous competition purposes (e.g. protection of domestic SMEs, promotion of

<sup>7</sup> It is desirable that competition laws have simple and clear competition objectives, so that authorities are more effective. This also encourages international convergence and reduces risks. When the political, economic, or institutional conditions that prevail allow only for competition laws with non-competition objectives, then these elements should be taken into account in any proposal for convergence.

specific local employment or domestic production activities, etc.). This is not limited to emerging competition law regimes. Some examples of strategic use of competition law are to be found in developed market economies (Mariniello et al. 2015). Authority decisions that are not strictly based on non-competition criteria can increase the uncertainties faced by foreign producers and affect their incentives to invest, export, and innovate (ibid). Hence, strategic use of competition policy at a national level to further competition-unrelated national goals can significantly impair trade and investment flows, compromising the economic growth potential in the country in question (Neven and Röller 2005).

In order to minimize the distortive effects of competition law and enforcement on trade flows, several enhancements in the competition policy related ecosystem might be required. The following section proposes specific steps to be taken to facilitate the development of a more effective competition policy ecosystem, which will reinforce the international rules-based trade agenda and its associated benefits.

### 3.1.1. Multidimensional awareness raising

The first area concerns intensified awareness raising regarding: (i) the type and impact of current anticompetitive practices; and (ii) the mutually reinforcing objectives and interconnections of the trade and competition policy agendas. Competition policy should cease to solely exist as a stand-alone island isolated from the mainland of the global political economy as it is “deeply intertwined with trade, foreign investment, free movement of goods, services and capital, the law of intellectual property, sectorial regulation, and the wide variety of proposed and actual industrial policies” (Fox 2015).

The proposed socialization should be advanced at an international, regional, as well as national level through diverse mechanisms and in a multitude of relevant fora such as the ICN, UNCTAD, OECD, and, when feasible, the WTO. For instance, when the international community is ready, work should resume in the Working Group on Trade and Competition Policy at the WTO, which is still extant and could serve (as it did in the past) as a powerful vehicle for the promulgation of competition policy principles and approaches in a multilateral setting (Anderson and Müller 2015). Such work might also point to the cost of abusive usage of competition policy that furthers non-competitive goals.

In addition, to better inform the debate among policy-makers and in academic circles, the development of an independent data and information platform to collect, organize, and disseminate information about government and private actions that affect the well-functioning of markets with an international dimension would be of essence.<sup>8</sup> Such a platform could also empower civil society, the media, and other relevant stakeholders by providing them with data and analyses, enabling them to scrutinize the decisions of national and international authorities and businesses.

In order to fill the current void and need for the neutral and systematic provision of competition-related data of international relevance, the main database underpinning such a platform would contain documentation of actions including:

- Competition law enforcement cases that discriminate against foreign firms;
- Proposals or decisions in trade policies and trade laws, specifically anti-dumping and safeguards, that not only affect competition but can induce anticompetitive practices like cartelization or abuse of dominance;
- Government decisions that affect competitive neutrality principles, specifically in relation to regulations that benefit SOEs;
- Decisions that affect competition such as discriminatory subsidies, industrial policies, and tax exemptions;
- Abuse of buying power in international supply chains; and
- Changes in national competition laws that intentionally handicap foreign firms.

This multidimensional awareness raising would be an important step in preparing further work suggested in this paper, and the related platform would serve as a source of information for policy-makers and interested stakeholders to engender further thinking.

The above list is indicative and could be enriched with reference to additional developments and actions. The database should be publically available on a dedicated website. The website would include a search engine that could organize information in a way that is efficiently and simply interpreted by interested parties.

### 3.1.2. Enhanced competition policy coordination and collaboration at the international level

Second, a globalized economy driven by international and deeply interconnected commercial activities requires an effective, coordinated, and collaborative approach not only to trade and investment but also to competition policy. International cooperation and coordination in the field of competition policy have never been more important than today, as competition agencies increasingly review multi-jurisdictional mergers and investigate conduct that spills across borders. The most complete way to minimize inconsistency in competition decisions in a multi-jurisdictional world would be to have one global supranational authority applying one competition law—a proposal that can only be deemed unrealistic in today’s world. Even if there were global political will, the implementation of this proposal would take a long time. Nevertheless, to at least reduce the risk and cost of potentially inconsistent antitrust decisions and to increase the benefits brought about by the opening of international

<sup>8</sup> This section is based on a proposal put forward by Simon Evenett for the E15 Expert Group on Competition Policy and the Trade System.

markets, a more realistic and practical method to improve coordination mechanisms among competition authorities can and should be considered. This would mean adopting an incremental approach, mainly using the institutional structures and instruments that already exist to optimize cooperation and collaboration step by step.

*Step 1: Stronger recognition of the need for an enhanced, sustained, and consolidated approach to informal international interactions*

When the decisions of authorities are divergent and create significant costs, the first step to address this situation would be to take advantage of and reinforce a process that started a few years ago and has proved to be an effective way to improve coordination and communication among competition authorities: i.e. networking and informal interactions among authorities in a broad range of international fora. In the recent past, competition authorities have benefited from collective cross-fertilization through networking activities in organizations like the ICN, OECD, UNCTAD, and regional competition fora. More concretely, among the different fora, the ICN is truly global, informal, and efficient in nature. The OECD Competition Committee is technically sophisticated regarding concrete experience and knowledge. And UNCTAD is the most efficient middleman between technical assistance donors and the youngest competition agencies that are most in need of improving their technical staff, investigation methodologies, and procedures. It is also a voice for developing countries.

In the past, informal cooperation has been extremely useful for competition authorities in identifying enforcement issues of mutual interest, leading to better understanding and sharing of knowledge on the elements of cases (e.g. market definitions, assessment of competitive effects, and the evaluation of other relevant factors such as efficiency claims, entry, etc.). Using informal channels has been less costly and bureaucratic than formal instruments, and therefore quicker and, in some cases, more efficient than formal arrangements. For instance, in merger review, informal cooperation has helped to standardize analytical criteria (for example in relevant market definitions), understand the procedural phases of other jurisdictions, and coordinate timing of the review. This type of cooperation has also been important to gauge possible effects of a competition authority decision in other jurisdictions.

In addition, trust is essential for effective cooperation. The importance of informal frameworks lies in the fact that they have led to greater trust and have further bred subsequent cooperation and overall convergence in competition law enforcement. The variety of international meetings where members of competition authorities regularly assemble are good opportunities to get to know each other and build relationships of trust that facilitate coordination and efficient communication. Different international organizations and regional networks have contributed to the policy dialogue, by providing platforms for agency staff and heads to get to know one another at conferences and workshops.

The ICN, for example, organizes annual meetings and periodic workshops on specific enforcement and policy topics—including mergers, unilateral conduct, cartels, advocacy, and agency effectiveness. The OECD Competition Committee—its working parties, international forums, and regional centres—holds meetings throughout the year with senior competition officials from over 50 countries to discuss key issues, as well as a Global Forum with almost 100 jurisdictions. Regional networks, such as the European Competition Network or the European, Asian, and Latin American regional centres for competition, hold other meetings. This possibility for case handlers and heads of agencies to contact their international counterparts has been instrumental for effective cooperation and coordination in multi-jurisdictional cases and for improving the quality of their analysis and the alignment of their decisions with international best practices.

Such informal interactions and cooperative efforts should be supported and further synergies explored wherever possible. Moreover, informal international gatherings could serve to further coordinate and galvanize support for the development and implementation of the most effective competition practices and laws.

As discussed above, not all countries have been able to effectively integrate best practices into their legal frameworks. Competition agencies, not limited to developing countries, have encountered difficulties in advocating and implementing changes in their respective competition regimes. More work needs to be done among competition authorities to assess strategies of successful advocacy so that competition policy in these jurisdictions can move closer to international standards of best practice.

To address this concern, it is proposed to build a strategy sustained on three elements, using the aforementioned informal interactions and cooperative efforts and exploring their synergies to promote an appropriate implementation of best practices.

- First, the ICN harnesses OECD's technical capacities and its own networking capabilities to develop and strengthen recommendations and best practices in those areas that need further development.<sup>9</sup>
- Second, the ICN develops a “model” advocacy strategy aimed at assisting competition agencies, principally young authorities, to persuade lawmakers to change the existing legal frameworks as necessary to comply with best practices.<sup>10</sup> This would facilitate advocating with legislatures and other policy-makers for the amendment of competition regimes.
- Third, the ICN, drawing on the comparative advantages of UNCTAD, provides technical assistance and capacity building to competition jurisdictions to implement internationally recommended practices. The ICN and UNCTAD would collaborate in designing a worldwide strategy to consolidate these efforts in implementing recommended practices. An evaluation of the results could be presented during the ICN's annual meetings.

<sup>9</sup> Most of the recommended practices developed to date and implemented in current competition regimes are concentrated in merger reviews.

<sup>10</sup> It is clearly understood that political realities are different in every country, and as a consequence specific strategies will be different. The “model” advocacy strategy which is proposed will set out major lines and guiding principles based on positive experiences from other jurisdictions. Each authority shall define the specific actions in accordance with their own circumstances and level of development.

## *Step 2: Strengthening voluntary international joint investigation and decision-making on multi-jurisdictional mergers*

As a second step, international cooperation and coordination initiatives could focus on multi-jurisdictional mergers as the most important source of potentially conflicting decisions taken by competition authorities. While the extension of true supranational decision-making beyond some existing regional bodies is not likely in the short term, some of the more experienced competition agencies could work together more effectively by voluntarily collaborating in joint investigation and enforcement.

To advance such joint investigation and enforcement in practical terms, a single coordinating authority for the merger investigation in question could be nominated. The role of this authority would be limited to the collection of information and coordinating activities among investigating authorities in the jurisdictions of relevance to the international merger. In this case, the coordinator could mainly play a procedural role, undertaking those activities that would otherwise be duplicated between independently investigating authorities. Alternatively, the coordinating authority could take on more leadership in the case, for example by undertaking analysis of common effects. Under no circumstances, however, should this limit the ability of national competition authorities to take action on their own behalf if they so choose.

Additionally, the ICN could provide a forum for the identification of a coordinator or a lead authority in such multi-jurisdictional cases, perhaps on the basis of where the merging parties have the largest turnover. This mechanism of practical coordination could also be applied for international cartel and unilateral conduct cases that have multi-jurisdictional effects.<sup>11</sup>

A useful complement to such a system of international cooperation in enforcement would be domestic legislation allowing for recognition of foreign competition decisions. At present, competition agencies can and do cite the decisions of their counterparts as relevant evidence in support of their decisions. However, there is no explicit recognition provided in law. This could be useful, especially if a lead agency is carrying out some of the analysis. For example, a competition authority might want to be able to adopt the market definition assessed by another competition authority, subject only to checks that the market conditions in the two jurisdictions are sufficiently similar. Legislation could explicitly state that decisions of foreign competition authorities can be taken into account as relevant evidence in assessing both the substance of a given case and in determining the resources to be devoted to the investigation.

These or similar approaches could help reduce the economic costs of the lack of coordination among competition authorities. Still, it is important to recognize that all sources of inconsistencies cannot be completely eliminated, especially those originated through competition laws whose mandate is not limited to the evaluation of competition effects.<sup>12</sup> Indeed, any such approach, at least initially, would probably be limited to a group of more experienced competition authorities that share similar mandates and trust one another's reputation for analysis and procedural rigour.

### 3.1.3. Working towards bilateral or regional dispute resolution and appeal mechanisms

As a third issue, in discussing the links between trade and competition, it would be natural to consider whether countries negotiating FTAs (bilaterally or regionally) could evaluate whether dispute settlement mechanisms of any sort can be applied to cases where divergence of competition policies in different countries or competition decisions on international matters impose economic costs—either because of inconsistencies between national laws or decision-makers taking different views on a case, even when the legal framework and the market are the same. A truly multilateral dispute resolution mechanism might not be feasible in the medium term. However, the inclusion of such mechanisms in bilateral and regional FTAs could present an opportunity to experiment and then further explore multilaterally. To date, competition policy related provisions in FTAs have largely been exempt from the dispute settlement mechanism of these regional agreements. However, exploratory work towards the introduction of such mechanisms can still be considered, and dispute resolution mechanisms may also be furthered in the future through new emerging FTAs.<sup>13</sup>

Two kinds of dispute settlement mechanisms could be envisaged: (i) state-to-state dispute settlement mechanisms modelled on existing mechanisms established through FTAs for other areas of trade policy; and (ii) mechanisms allowing private companies concerned by individual decisions to seek redress at the international level. These would fulfil different functions and consequently be subject to different rules and limitations.

Further to the above, any state-to-state dispute mechanism would have to relate to challenges by one state against the competition policy of another state. Individual decisions by a state's competition authority would be outside the purview of such a mechanism. It would simply allow states concerned about any discriminatory provisions in another state's competition laws (or consistent practice or guidelines) to request a change in such policies if, for example, systemic discrimination against foreign businesses

<sup>11</sup> See Report of International Competition Policy Advisory Committee to the Attorney General and Assistant Attorney General for Antitrust (ICPAC) (2000), pp. 76-82.

<sup>12</sup> This discussion is nicely analyzed in the think piece prepared by Mariniello et al. (2015) for the Expert Group. Possible ways to address the problem of inconsistencies of law are considered in the next two subsections below.

<sup>13</sup> For greater detail and analysis, see the authoritative E15 think piece authored by Laprévote et al. (2015).

is found to exist as the outcome of a formalized dispute resolution process. Such a limited mechanism would seem appropriate as competition law is an important part of the business environment, and any emerging multilateral framework or regional rules containing principles of non-discrimination should include a means of settling disputes. At the same time, the limited purview of the envisaged mechanism would fully recognize that it is important that states should not get involved on behalf of an individual company that may be aggrieved about its specific treatment in a case, as that would potentially politicize competition law enforcement and risk losing this policy area's greatest strength—i.e. its focus on the consumer rather than balancing rival producer interests.

#### 3.1.4. Promoting convergence in competition regimes through peer reviews

Finally, since the first competition regime entered into force, nations have witnessed significant convergence in competition enforcement procedures and methodologies of analysis among antitrust agencies. The peer reviews undertaken within the frameworks of the OECD and UNCTAD contribute to achieve further convergence across the globe (Box 1).

Peer reviews are a powerful instrument to assess competition law and policy. The process is divided into two parts. The first involves an evaluation by an independent expert with advanced knowledge and experience regarding best international practices and recent developments in competition law and policy. These experts also have knowledge of the legal framework and decisions taken by a jurisdiction that has voluntarily submitted its competition law and policy for assessment. The second part consists of a peer review by an authority and a public discussion about the findings and recommendations with other competition authorities.

#### Box 1: OECD and UNCTAD Peer Reviews of Competition Laws and Policies

The OECD has conducted in-depth reviews of competition laws and policies in the following countries. Country reports have been peer reviewed before publication.

Australia	European Union	Italy	Russia
Argentina	Finland	Japan	Spain
Brazil	France	Korea	South Africa
Canada	Germany	Mexico	Sweden
Chile	Greece	Netherlands	Switzerland
Colombia	Honduras	Norway	Chinese Taipei
Czech Republic	Hungary	Panama	Turkey
Denmark	Ireland	Peru	Ukraine
El Salvador	Israel	Poland	United Kingdom

The reviews are available at: <http://www.oecd.org/daf/competition/countryreviewsofcompetitionpolicyframeworks.htm>

UNCTAD has carried out voluntary peer reviews of competition law and policy since 2005 in the following jurisdictions.

Albania	Jamaica	Philippines	Ukraine
Armenia	Kenya	Senegal	West African Economic and Monetary Union
Benin	Mongolia	Serbia	Zambia
Costa Rica	Namibia	Seychelles	Zimbabwe
Fiji & Papua New Guinea	Nicaragua	Tanzania	
Indonesia	Pakistan	Tunisia	

The reviews are available at: <http://unctad.org/en/Pages/DITC/CompetitionLaw/Voluntary-Peer-Review-of-Competition-Law-and-Policy.aspx>

Peer reviews represent a unique opportunity for competition authorities to receive feedback and engage in dialogue with international peers fully dedicated to competition law and policy. And, as it is well known, peer reviews have become a legitimate source of pressure on authorities to improve their competition policies and adopt best practices.

Voluntary peer reviews have substantially analysed and commented on existing enforcement frameworks and they have advanced sound recommendations in jurisdictions that are either considering adopting a new competition law, or are at an early stage of enforcing their laws, or are making changes to their existing regimes, all with a view to improving their legal and institutional frameworks.

It would be worth considering the introduction of peer reviews in FTAs as a mechanism to evaluate competition decisions in jurisdictions. Further, the conclusions and recommendations of such in-depth reviews should be public, even discussed in legislatures. It would also be advisable to make public the peer review process.

## 3.2. Applying Competition Policy to Optimize Current International Trade Frameworks

Recognizing the fundamental complementarity of competition law/policy and trade policy, multiple initiatives have been taken at the international level to attempt to formalize their interrelationships and better harness related synergies. Some of these initiatives, including those taken in the framework of the United Nations, the WTO, and the historic Havana Conference on Trade and Employment of the 1940s, are described in Appendix A. A common thrust of these past initiatives was to recognize the ability of anticompetitive practices and arrangements to undermine the benefits of international trade liberalization. It must be noted, however, that none of these initiatives has resulted in a binding framework that ensures the optimal application of competition policy in relation to trade and investment.<sup>14</sup>

Since the failure of the WTO Working Group on the Interaction between Trade and Competition Policy to yield agreement on specific policy proposals, international cooperation efforts have focused largely on competition policy *per se*, as opposed to the interface between trade and competition policy. Much useful work has been done by organizations such as the ICN, OECD, and UNCTAD in addition to non-governmental organizations like CUTS and the national competition authorities of leading jurisdictions.

While respecting entirely the core mission of national competition agencies to investigate and deter anticompetitive practices that harm their domestic consumers, as well as the focus of organizations like the ICN on competition policy *per se*, this paper suggests that renewed attention directed at the interface with international trade policy is also necessary. Rather than

focus on preventing anticompetitive measures that may undermine the trade agenda, the paper suggests that the positive role the competition policy community can play in optimizing current international trade frameworks should be enhanced. Such an approach would require the introduction of competition policy elements in the trade policy decision-making process, within each country, to improve the market efficiency effect and to inject greater competition.

Two particular areas of application for such an approach come to mind. First, the competition policy community could inform decision-making regarding flexibilities provided under existing trade rules. Second, competition policy could be relevant in rethinking the regulatory frameworks for SOEs in view of the limited rules on competitive neutrality embodied in current trade rules.

### 3.2.1. Competition policy and its role in the decision-making of trade measures

Regarding the first area of application—i.e. flexibilities and gaps in existing trade rules, the following matters (introduced in section 2.2) are of concern: the use of SPS standards and TBTs; FDI restrictions; barriers to external competitors in government procurement; anticompetitive services regulation; trade defence mechanisms; and the use of margins between applied and bound tariffs. At the multilateral level, the WTO dispute settlement mechanism has been designed to address the abusive or protectionist use of such instruments. Yet, resorting to the WTO dispute settlement mechanism takes place *ex post*, in other words, once the abuse has taken place (as opposed to preventing it from happening).

In adopting a more proactive *ex ante* approach, it would be advisable for each WTO member to invite its competition agency to evaluate on the basis of competition merits any decision related to anti-dumping, tariff modification, government procurement, SPS or TBT measures, FDI, and services regulation, and to emit a proposal in each case. Before the competition authority makes its proposal, it would have the obligation to consult with the parties affected by the decision—government, businesses, and consumers.

The proposal of the competition authority would be public and it would have a mandatory status. If the government were opposed to the proposal, as an ultimate option, the president or trade minister (or equivalent) would be able to veto the decision of the competition authority, with the requirement to make public the criteria and arguments on which the veto is based.

In concrete terms, this empowerment of national competition authorities at a country level could encompass the following.

<sup>14</sup> Chapter 5 of the Havana Charter, addressing the impact of anticompetitive practices on international trade, was never brought into effect. The UN Set of Principles on Competition, while a useful point of reference for countries implementing national legislation, is non-binding in nature. The work of the WTO Working Group on the Interaction between Trade and Competition Policy did not yield agreement on particular policy proposals, and in 2004 the work was formally placed on hold.

1. In the case of *tariffs*, the competition authority would have the mandate to evaluate the full cost-benefit analysis of the tariff movement from the perspective of domestic market efficiency.
2. In the area of *government procurement*, ongoing efforts to broaden the membership of the WTO Agreement on Government Procurement, coupled with the recent revision of the Agreement's text, hold the promise of broadening and deepening the extent to which this sector, traditionally closed in many countries, is exposed to competitive market forces. This can only help to achieve better value for money for governments in their infrastructure investments and the delivery of socially important goods and services. Competition agencies should encourage this trend, while calling attention to the harm caused by “buy national” measures and working with procurement officials to eradicate collusion among suppliers (Anderson and Müller 2015).
3. When it comes to *services and investment regulation*, the competition policy authority, through analysis, could evaluate the concrete welfare and market efficiency impact of the proposed regulatory changes to better inform *ex ante* national decision-making (before protective regulatory barriers are erected). Additionally, competition authorities could also provide opinions on services liberalization proposals such as the Telecommunications Reference Paper.
4. In a similar vein, in cases related to *TBT and SPS measures*, the competition authority could conduct an independent analysis of the market impact of the measures considered. It is not expected that the competition authority would substitute the technical analysis of the responsible specialized government agency. What should be expected, however, is to have an independent analysis with a balanced approach that evaluates producers, consumer interests, the market structure, as well as the market effect of the measure.<sup>15</sup>
5. As for *contingency trade measures* such as anti-dumping, the input of competition agencies could provide for an additional and more balanced assessment of the competitive effects of the conduct under examination. In this case, the competition agency should make a full evaluation of the impact of the alleged “dumping” or other behaviour, identifying the mechanisms by which any alleged harm will result from the low prices.<sup>16</sup>

The appeal of greater empowerment of national competition agencies is manifold. Firstly, such an approach cannot be perceived as a foreign imposition of legal frameworks onto national governments. (This was the perception that some developing countries had during the discussion of trade and competition in the WTO.) Secondly, the approach would represent a domestically integrated pro-market efficiency

mechanism that effectively reinforces the main objectives of the international trade agenda. Thirdly, the *a priori* application of such an approach is an advantage as it allows for avoiding the societal costs incurred in implementing distortive and protectionist measures (accompanied by decreases in consumer welfare and increases in market inefficiencies). Fourthly, the approach would allow national governments to proceed with any original decision to implement a particular measure but it would increase the costs for governments to proceed with an anticompetitive, distortive proposition. Lastly, this empowerment of national competition authorities would be easily implementable as most countries—that is over 120 jurisdictions—have competition policy agencies that would be able to play the role proposed above.

This proposal would imply an important use of resources for competition agencies. Each agency would have to make an assessment on the best use of their human and budgetary resources in terms of net benefits for society. A gradual approach to the incorporation of competition agencies in trade decision-making might be necessary.

### 3.2.2. Ensuring competitive neutrality

Maximizing the benefits of trade and investment flows in today's era characterized by a strong presence and impact of SOEs on the international scene would demand continued and enhanced promotion of a level playing field between private and state-owned companies. The creation of such a fair and pro-competitive environment should rest with competition policy authorities. These authorities should assess the current regulatory framework for SOEs in order to issue public recommendations on a relevant set of competitive neutrality principles. Increasingly, governments are bringing competition principles into the impact assessment of their measures.<sup>17</sup> Potential distortions regarding state ownership (and related forms of control) of, and subsidies to, companies involved in competitive, commercial activities could be brought consistently into this framework. Any such proposal would need to preserve the state's right to determine ownership regimes.

This could happen purely domestically, as an outcome of impact assessment policies. However, the growing concern over the international activities of SOEs creates scope for an international agreement that could define some key principles to ensure competitive neutrality both in cross-border and domestic regulation of SOEs. As Gestrin et al. (OECD Secretariat 2015) further elaborate: “in the absence of such an agreement, governments could increasingly resort to their bluntest policy instrument—denial of market access. It would therefore seem desirable to reach some form of mutual international agreement.”

The publicly released summary of the TPP Agreement (USTR 2015)—concluded in October 2015, subject to ratification by the parties—offers further insight on the way forward.

<sup>15</sup> Regarding TBTs, Santa Cruz Scantlebury and Trivelli (2015) provide analysis on the interaction between intellectual property and competition enforcement, and the use of standards as a legitimate instrument to promote consumer welfare.

<sup>16</sup> For an overview of the interface between trade defence instruments and competition policy, see Laprévote (2015).

<sup>17</sup> Documented for example in the OECD's 2014 review of Experiences with Competition Assessment. <http://www.oecd.org/daf/competition/Comp-Assessment-ImplementationReport2014.pdf>.

### 17. State-Owned Enterprises (SOEs) and Designated Monopolies

*All TPP Parties have SOEs, which often play a role in providing public services and other activities, but TPP Parties recognize the benefit of agreeing on a framework of rules on SOEs. The SOE chapter covers large SOEs that are principally engaged in commercial activities. Parties agree to ensure that their SOEs make commercial purchases and sales on the basis of commercial considerations, except when doing so would be inconsistent with any mandate under which an SOE is operating that would require it to provide public services. They also agree to ensure that their SOEs or designated monopolies do not discriminate against the enterprises, goods, and services of other Parties. Parties agree to provide their courts with jurisdiction over commercial activities of foreign SOEs in their territory, and to ensure that administrative bodies regulating both SOEs and private companies do so in an impartial manner. TPP Parties [also] agree to not cause adverse effects to the interests of other TPP Parties in providing non-commercial assistance to SOEs, or injury to another Party's domestic industry by providing non-commercial assistance to an SOE that produces and sells goods in that other Party's territory...*

At a minimum, the importance given to the subject of SOEs and monopolies in the TPP has further highlighted the significance of these topics for future deliberations on governance in the global economy.

### 3.3. Harnessing the Power of Free Trade Agreements

The interface between competition and trade policy has been extensively developed in the context of bilateral and regional FTAs. The vast majority of FTAs concluded between WTO members now contain detailed provisions dealing with competition law and policy-related matters.<sup>18</sup>

While the core objective of an FTA is typically the elimination of discriminatory practices and artificial barriers to trade and investment, integrating competition policy principles and provisions has grown in importance. New and emerging FTAs increasingly include specific chapters and provisions on competition matters. The initial objective of incorporating these provisions in FTAs is to prevent the benefits of international trade from being diminished by anticompetitive practices. There is an additional benefit of competition, which is to avoid domestic anticompetitive behaviour that affects market efficiency in sectors that are not necessarily tradable but that do have an impact on tradable goods.

The competition provisions in FTAs range from ambiguous obligations through to deep commitments. At one end of the spectrum, there are provisions that lay out, in very broad terms, the obligation of promoting competition within the signatory parties, without further elaboration. As we

move to the other end of the spectrum, FTA obligations are more clearly defined and involve: adopting or maintaining competition laws; addressing anticompetitive practices; establishing mechanisms to facilitate and promote competition policy; considering the impact of regulation on competition; and promoting a competition culture (Laprévôte et al. 2015). These provisions can go further. They can define the design of competition regimes to be established in the signatory countries, or even determine which anticompetitive practices the signatory parties should address—i.e. anticompetitive agreements, abuses of market power, and anticompetitive mergers.

As has been noted *supra*, there may also be provisions in trade agreements on the treatment of SOEs and designated monopolies with related concerns over competitive neutrality. Accordingly, some FTAs are very stringent regarding competitive advantages provided to SOEs, while others establish that public enterprises should have equal treatment as private companies and should therefore be subject to competition laws. What is more, several FTAs now also contain provisions on positive and negative comity, in which the parties have agreed to cooperate on a reciprocal basis in implementing mechanisms for competition law enforcement. These can range from notifications and consultations of the enforcement activities, investigatory assistance, exchange of information, and enforcement coordination.

The inclusion of competition provisions in FTAs has developed in different ways, thus providing diverse legal frameworks (Laprévôte et al. 2015). For example, the approach taken in the North American Free Trade Agreement requires parties to adopt measures to deal with anticompetitive behaviour and the establishment of competition regimes within the signatory parties. Provisions on cooperation and coordination, SOEs, and designated monopolies are also included.

The EU has adopted by far the most comprehensive approach for consistent rules and the harmonized implementation of competition law, which is applied across EU member states. All members have delegated powers in merger control and antitrust to a supranational authority, the European Commission. Member state anticompetitive acts and measures with cross-border effects are included in the prohibitions. When it comes to trade in the internal market, all tariff and non-tariff barriers have been eliminated. Members of the EU enforce their national competition laws, which are harmonized, and have a model of regional coordination, the European Competition Network.

As a further important illustration, the relevance of competition policy for international trade policy is seen clearly in the framework of the TPP Agreement. The summary of chapter 16, released by the Office of the United States Trade Representative (USTR 2015), reads as follows.

<sup>18</sup> See the think piece produced by Laprévôte et al. (2015) for comprehensive analysis of this issue.

## 16. Competition Policy

*TPP Parties share an interest in ensuring a framework of fair competition in the region through rules that require TPP Parties to maintain legal regimes that prohibit anticompetitive business conduct, as well as fraudulent and deceptive commercial activities that harm consumers. TPP Parties agree to adopt or maintain national competition laws that proscribe anticompetitive business conduct and work to apply these laws to all commercial activities in their territories. To ensure that such laws are effectively implemented, TPP Parties agree to establish or maintain authorities responsible for the enforcement of national competition laws, and adopt or maintain laws or regulations that proscribe fraudulent and deceptive commercial activities that cause harm or potential harm to consumers. Parties also agree to cooperate, as appropriate, on matters of mutual interest related to competition activities. The 12 Parties agree to obligations on due process and procedural fairness, as well as private rights of action for injury caused by a violation of a Party's national competition law. In addition, TPP Parties agree to cooperate in the area of competition policy and competition law enforcement, including through notification, consultation and exchange of information. The chapter is not subject to the dispute settlement provisions of the TPP, but TPP Parties may consult on concerns related to the chapter.*

Overall, trade policy instruments have become important platforms for cooperation in competition enforcement. Nations throughout the world have paid special attention to incorporating competition provisions in FTAs and other economic integration arrangements (particularly the US and the EU), a trend that has started to facilitate the necessary cooperation and coordination between national competition authorities when enforcing competition law.

In addition to fostering further cooperation and convergence in enforcement matters, future or presently negotiated free trade and investment arrangements could act as a vehicle for incremental harmonization of competition laws and practices in the absence of an international agreement on these issues. To this end, the development of a model competition chapter for inclusion in FTAs would greatly facilitate the process.<sup>19</sup>

The first step towards the development of such a model chapter would be the identification of common areas of competition policy that could be included. The model chapter should include enforcement provisions that would be developed by the OECD and ICN, covering abuse of market power, cartels, and mergers. Existing ICN and OECD best practice documents already contain much of the necessary material. Regarding the treatment of SOEs and designated monopolies, the development of a model

text by the ICN<sup>20</sup> under the principles of transparency and non-discrimination could be the way forward.<sup>21</sup> The model chapter should include competition advocacy provisions aimed at raising awareness of the role of competition and promoting a competition culture.<sup>22</sup> The inclusion of provisions on procedural standards for competition law enforcement—such as procedural fairness, transparency, and non-discrimination—is also crucial to ensure that the decisions taken under the umbrella of FTAs are fair, reasonable, transparent, and effective.

Still, successful promotion of the adoption of a competition chapter among authorities and governments will largely depend on the incentives and potential costs of including competition provisions in an FTA. To highlight and enhance the benefits of such an adoption, it would be useful to: (i) precisely identify the key common areas of agreement in FTAs and reconcile the differences between approaches; (ii) increase awareness regarding the benefits of competition provisions in FTAs in order to reduce political costs; (iii) facilitate technical assistance to states that face difficulties in implementation; and (iv) assess the potential trade concessions that might be needed to incorporate competition clauses in FTAs.

<sup>19</sup> This section is derived substantially from Laprévotte et al. (2015).

<sup>20</sup> The ICN has already developed recommendations to assist agencies in the application of unilateral conduct rules regarding state created monopolies.

<sup>21</sup> For more in-depth analysis of the competition perspective on SOEs, see OECD Secretariat (2015).

<sup>22</sup> ICN has developed different products for competition advocacy that could inspire this section of the chapter.

# 4. Next Steps

As highlighted in the introduction to this paper, the world economy today faces a potentially daunting array of challenges. Globalization has become a reality and has lifted millions of citizens out of extreme poverty. Yet recovery from the global financial and economic crisis has been slow and may be faltering in important parts of the world. This brings a renewed threat of protectionist measures that could exploit gaps or flexibilities in the global trade system and that respond to the needs of particular national interest groups while further diminishing prospects for world trade and economic growth.

Without denying the complexity of the challenges involved in strengthening global growth, the analysis and proposals herein have attempted to scope one important dimension of the problem—i.e. the incompleteness of the institutional and policy infrastructure to ensure open markets and a dynamic and competitive global economy. This policy options paper elaborates on two broad proposals: (i) international convergence and (ii) injecting competition into international trade.

Both proposals encompass a number of dimensions and work programmes that could enhance the (already vital) contribution of competition policy to global prosperity and development. Many of these efforts would represent extensions of initiatives already being taken at the national level or in the context of new FTAs, including the recently concluded TPP Agreement. As such, while bold and ambitious in some respects, the policy options also build very concretely on practical steps that are underway as well as exploratory work already initiated in various relevant international organizations, NGOs, academic institutions, and think tanks. In summary, the options include:

- Multidimensional awareness raising concerning the role of competition policy in ensuring that market forces work to the benefit of all citizens and are not distorted by cartels and other anticompetitive practices;
- A series of practical and incremental steps aimed at enhancing cooperation and coordination in the implementation of competition policy at the international level;
- Progressive introduction of international dispute resolution and appeal mechanisms in ways that elicit the support and participation of national competition authorities;
- The promotion of convergence in competition regimes through enhanced peer reviews with a view to improving competition policies and adopting best practices;
- Enhanced engagement of national competition authorities in assessing and advising on the

implementation of trade measures that potentially restrict competition;

- The elaboration of new rules on competitive neutrality and state monopolies as tools to address the role of SOEs; and
- General efforts to broaden the application of recent innovative approaches to the trade and competition interface in regional and bilateral trade agreements. In this context, a model chapter on competition policy for FTAs could be developed by the ICN with technical advice provided by the OECD and UNCTAD. In addition, the migration of current approaches into the multilateral trading system itself could be considered at an appropriate stage. At a minimum, the WTO should presently be taking stock of related developments and generating databases of possible approaches.

It is advisable that competition authorities strategically prioritize the implementation of these proposals, within a framework of gradualness and sustainability. Given their limited resources, they should place particular emphasis on choosing those options that maximize the impact of their interventions and help enhance the effectiveness and efficiency of their actions.

The policy options paper emphasizes that the efforts to be undertaken in the international competition policy arena can and should build on the very important work already being conducted on related issues by organizations such as the ICN, OECD and UNCTAD. A practical and incremental approach to the optimization of competition law and policy vis-à-vis the global trading system is envisioned. The willing participation of leading competition agencies and other advocates of progressive competition policy is vital. In this way, it is believed that the framework to emerge would make an essential contribution to a more inclusive and balanced globalization underpinning world prosperity and development in the decades to come.

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The papers commissioned for the E15 Expert Group on Competition Policy and the Trade System can be accessed at <http://e15initiative.org/publications/>.

# Appendix A: Competition Policy in the Multilateral Trading System: Historical Perspective and Developments

The competition policy agenda is not new to the multilateral trading system. Anticompetitive practices and policies to combat them have been considered in the deliberations of the international trade community since the early second half of the 20<sup>th</sup> century. From the days of the Havana Charter to the 2004 Decision on Singapore Issues, competition policy has been a core part of the discussions in the multilateral trade domain.

## The Havana Charter

In the late 1940s, trade liberalization was deemed critical for the recovery of the world economy, especially for the United States whose external policy advocated the opening of markets to rebuild the European countries following World War II. Accordingly, the United States promoted the inclusion of competition principles in the new world trade regime in an effort to address the international cartels harming trade<sup>23</sup> (reflecting its opposition to German cartels and Japanese zaibatsu).<sup>24</sup>

In this endeavour, under the auspices of the United Nations, member countries started negotiating the Havana Charter<sup>25</sup> as a first attempt to govern and set forth unified rules for international trade *and* competition. When the Charter was under negotiation, no more than 10 jurisdictions—all of them the developed countries—had a competition law to address anticompetitive practices.

In 1947, a draft of the Havana Charter called for the creation of an International Trade Organization (ITO). The scope of action of the Charter was far-reaching as its rules covered a wide range of disciplines including employment, commodity agreements, and many aspects of international trade—quantitative restrictions, subsidies, export taxes, discrimination, and tariff reduction. One chapter of the Charter titled “Restrictive Business Practices” was exclusively devoted to fair trade measures dealing with anticompetitive practices. In particular, Article 46 section 1 of the Charter provided that Members “*shall take appropriate measures and shall co-operate with the Organization to prevent, on the part of private or public commercial enterprises, business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade (...)*.”<sup>26</sup>

During the drafting of the Charter, the document deviated from the one envisioned by the US negotiators, and the Havana Charter was never ratified. However, the Charter was the first joint effort introducing pro-competition principles and rules in international trade instruments and its significance is hence not to be overlooked.

## General Agreement on Tariffs and Trade

At the same time as the Havana Charter discussions were taking place, the General Agreement on Tariffs and Trade (GATT) was under negotiation in Geneva. The GATT, which came into force in 1948, captured most of the commercial policy clauses developed under the Havana Charter, with the exception of those commitments expressly addressing the relationship between trade and competition policy.

In the following years, the GATT-powered multilateral negotiations mainly focused on the progressive reduction of trade barriers and the non-discriminatory treatment of imported goods. Still, through the introduction of (1) principles of non-discrimination in the form of the most-favoured nation and national treatments as well as (2) mechanisms to facilitate tariff bindings, the GATT had a significant impact on the competition landscape in the member states. At the time, competition law was in its infancy and an insufficient international consensus existed on competition-law-related issues.<sup>27</sup>

Nevertheless, during its existence, GATT deliberations included initiatives that attempted to incorporate international competition law. For example, at the Geneva Round of 1956, a commission of competition law experts was formed to analyse the extent to which the GATT was the appropriate forum to address competition policy issues. Additionally, the early negotiations of the Agreement on Trade Related Investment Measures (TRIMS) considered provisions on competition policy similarly to the negotiations regarding the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) which contemplated the introduction of competition policy as an important counterbalancing element to the intellectual property rights.<sup>28</sup>

<sup>23</sup> See Mehta, Pradeep Singh, and Udai S. Mehta. 2015. *Consequences of Cartelisation in Primary Commodities: Focus on Natural Rubber and Banana*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

<sup>24</sup> See Hoekman, Bernard M., and M. M. Kostecki. *The Political Economy of the World Trading System: The WTO and beyond*. 2nd ed. Oxford: Oxford University Press, 2001. Committeening. Through the datory Pricing,ng licy of the United States considered

<sup>25</sup> *Havana Charter for an International Trade Organization*, March 24, 1948 (United Nations Conference on Trade and Employment, Havana, Cuba); available at: [https://www.wto.org/english/docs\\_e/legal\\_e/havana\\_e.pdf](https://www.wto.org/english/docs_e/legal_e/havana_e.pdf)

<sup>26</sup> *Id.*

<sup>27</sup> See Taylor, Martyn D. 2006. *International Competition Law: A New Dimension for the WTO?* Cambridge University Press.

<sup>28</sup> See Santa Cruz Scantlebury, Maximiliano, and Pilar Trivelli. 2015. *Competition, Trade and Intellectual Property Rights*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

## World Trade Organization and the Singapore Issues

In 1995, the World Trade Organization (WTO) came into existence replacing the GATT. In December 1996, at the first WTO Ministerial Conference held in Singapore, the debate over the usefulness of competition law and policy in the international trade system was revived. Thus, competition policy—alongside investment, transparency in government procurement, and trade facilitation—was introduced into the agenda of the WTO.

By 1996, at least 50 jurisdictions in the world had adopted national competition laws. However, most of these jurisdictions did not have the necessary tools and capacity to address international anticompetitive practices and to reach consistent decisions with other jurisdictions when investigating international cartels or reviewing cross-border mergers.

The Singapore Ministerial Declaration marked the beginning of the discussions on the introduction of new agreements on competition policy in the WTO. In this regard, the Declaration mandated the creation of a Working Group on the Interaction between Trade and Competition as depicted in the following paragraph:<sup>29</sup>

*20. Having regard to the existing WTO provisions on matters related to investment and competition policy and the built-in agenda in these areas, including under the TRIMs Agreement, and on the understanding that the work undertaken shall not prejudice whether negotiations will be initiated in the future, we also agree to:*

*Establish a working group to examine the relationship between trade and investment; and establish a working group to study issues raised by Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework.*

## The Doha Round Negotiations and the Cancun Ministerial

In 2001, the Doha Ministerial Declaration returned to the discussion on the adoption of international competition rules in the trade agenda. The general approach was to use the disciplines of the multilateral trading system to promote convergence of competition law and some principles of enforcement like non-discrimination, transparency, and due process.

The Doha Declaration agreed to include competition policy in the new round of negotiations and to conclude a multilateral agreement on competition policy by 2015. In its work program, the Declaration established the specific

topics to be treated in the following years. To this end, paragraphs 23 to 25 on the interaction between trade and competition policy of the Doha Declaration point to the following (emphasis added):<sup>30</sup>

*23. Recognizing the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 24, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.*

*24. We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we shall work in cooperation with other relevant intergovernmental organisations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.*

*25. In the period until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, and provisions on hard core cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building. Full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them.*

By the time of the Cancun Ministerial Meeting in 2003, two contrasting positions on the Singapore issues had been brought into the discussion. Most of the major developed WTO members were interested in launching the negotiations on the Singapore Issues. In turn, the developing countries needed further clarification of the issues before embarking on the concrete negotiations. The developing countries were concerned that issues which were technical, complex, and perceived as unrelated to trade could take prominence in the negotiations agenda. Their capacity to implement such rules was also put to question. The two opposite views and the lack of consensus on the treatment of the whole package of issues led to the collapse of the Cancun Ministerial Meeting.

<sup>29</sup> The text of the Singapore Ministerial Declaration is available at: [https://www.wto.org/english/thewto\\_e/minist\\_e/min96\\_e/wtodec\\_e.htm#investment\\_competition](https://www.wto.org/english/thewto_e/minist_e/min96_e/wtodec_e.htm#investment_competition).

<sup>30</sup> The text of the Doha Ministerial Declaration is available at: [https://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm#interaction](https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#interaction).

August 2004 witnessed an adoption of a package in which all issues perceived as “not central” to the main trade agenda (among them competition policy) were removed from the WTO negotiations agenda at the time:

*Relationship between Trade and Investment, Interaction between Trade and Competition Policy and Transparency in Government Procurement: the Council agrees that these issues, mentioned in the Doha Ministerial Declaration in paragraphs 20-22, 23-25 and 26 respectively, will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round.”*

*“Trade Facilitation: taking note of the work done on trade facilitation by the Council for Trade in Goods under the mandate in paragraph 27 of the Doha Ministerial Declaration and the work carried out under the auspices of the General Council both prior to the Fifth Ministerial Conference and after its conclusion, the General Council decides by explicit consensus to commence negotiations on the basis of the modalities set out in Annex D to this document.”<sup>31</sup>*

In the aftermath of this decision, even though not abolished, the WTO Working Group on Trade and Competition Policy was designated “inactive” and has not resumed its work since then.

<sup>31</sup> Text of the “July package” available at: [https://www.wto.org/english/tratop\\_e/dda\\_e/draft\\_text\\_gc\\_dg\\_31july04\\_e.htm](https://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm).

# Appendix B: The Evolution of International Competition Policy: Key International Actors

The current competition law is defined, implemented, and enforced at a national level through national agencies and authorities. However, the emergence of abusive corporate behaviour with an international dimension prompted the creation of a set of institutions and working groups that have started exploring the international dimension of competition policy and the cooperation potential among the different national agencies. The key international actors in this domain are the International Competition Network, the OECD Competition Committee and UNCTAD.

## International Competition Network (ICN)

The ICN is a virtual network of national competition agencies with the objective to address cross-border issues of competition law and policy. Regarding the work and deliberations of the Network, its members participate in their individual capacity as competition agency heads and staff, as opposed to representing their governments.

The ICN was founded in 2001 by 15 member agencies.<sup>32</sup> Currently, the ICN includes 132 member competition agencies from 119 jurisdictions, a membership that spans the entire globe.

Since its inception, the ICN has developed a series of recommended practices which are consensus driven, non-binding policy recommendations created by and for the ICN members in order to inspire greater global convergence of the most effective practices. These practices have been formulated in the following areas: Merger Notification and Review Procedures, Merger Analysis and the Assessment of Dominance, Unilateral Conduct and Predatory Pricing, State-created Monopolies and on Competition Assessment.

The standards and recommended practices developed through the ICN platform have proved to greatly impact the development of national competition policy regimes. It has been estimated that approximately 25% of ICN members have undertaken a major legislative overhaul to align their antitrust regimes with the recommendations developed by the Network. More concretely, in countries like Brazil, Mexico, South Africa, Germany, Italy, and the EU, ICN's Recommended Practices inspired law reforms leading to significant resource savings.

In the development of its recommendations and analyses, the Network aspires to remain inclusive and cognizant of the different stages of development of the economies of its various members. In the areas where no consensus can be reached, the ICN focuses on fostering greater cooperative efforts accompanied by the so-called “informed divergence.”

Here, the ICN aims to identify the nature and sources of the apparent divergence, particularly by producing comparative reports. A broader dialogue on informed divergence then facilitates a consensus-building process for some of the more challenging issues.

The key element of the ICN's day-to-day work, however, is cooperation. While the ICN is not a forum for a case specific cooperation, the Network does explore overarching mechanisms for agency cooperation and interoperability to make competition systems more compatible. Currently, the ICN has a recommended practice on interagency coordination for merger reviews and is examining current practices regarding inter-agency cooperation in cartel matters.

## Organization for Economic Co-operation and Development (OECD)

From its very beginning in 1961, the OECD has addressed competition issues. After discussion in its Competition Committee, associated Working Parties<sup>33</sup> and Global Forum, the political decision-making body of OECD, the OECD Council, has issued Recommendations on Competition Law and Policy. The recommendations cover a wide variety of areas such as regulated sectors, hard core cartels and exchange of information, merger review, competition assessment, bid rigging, and international cooperation on competition law enforcement. OECD Council Recommendations are expected to be fully implemented by its member states as well as adhering non-member countries.

Still, particular attention might be merited in the case of the 2014 update of the 1995 Recommendation of the Council Concerning Co-operation between Member Countries on Anti-Competitive Practices affecting International Trade. It establishes a cooperation framework between competition authorities of the OECD members and adhering non-member countries<sup>34</sup> regarding the notification of cases and consultation related to the enforcement of competition laws. It also commits the OECD's Competition Committee to explore new avenues of international cooperation, including model agreements, and enhanced cooperation tools to avoid inconsistencies and costs created by multiple parallel investigations.

<sup>32</sup> Australia, Canada, European Union, France, Germany, Israel, Italy, Japan, Korea, Mexico, South Africa, United Kingdom, United States (with two competition authorities), and Zambia.

<sup>33</sup> Working Party No. 2 on Competition and Regulation and Working Party No. 3 on Cooperation and Enforcement.

<sup>34</sup> Adhering non-member countries include Brazil, Colombia, Costa Rica, Latvia, Lithuania, Romania, and Russia.

## United Nations Conference on Trade and Development (UNCTAD)

A decade after its establishment in 1964 with the aim to assist the developing countries in implementing relevant economic policy, UNCTAD developed a set of proposals related to harmful business practices. The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of the Restrictive Business Practices on International Trade (otherwise also known as the UN Set) adopted on consensus in 1980<sup>35</sup> recognized that restrictive business practices limit access to markets and have an adverse effect on trade, particularly in the developing countries. The UN Set was not binding, but by being aspirational, these principles and rules laid the foundation for further international cooperation on competition issues.<sup>36</sup> In July 2015, the UN Set on Competition Policy was reviewed by more than 350 competition specialists from 70 countries.

In addition to the UN Set, UNCTAD has developed a Model Law which has guided developing countries in their drafting and adoption of national competition laws. The Model Law, which is periodically reviewed, establishes standards that encourage a high level of convergence on general principles and best practices when enforcing national competition laws. It also provides for cooperation when countries implement legislation against transnational restrictive business practices. The latest Model Law was reviewed in 2010.

<sup>35</sup> The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, Conference on Restrictive Business Practices, U.N. Doc. TD/RBP/Conf/10/Rev.2 (Apr. 22, 1980)

<sup>36</sup> See Hollmann, Hugh M., and William E. Kovacic. 2011. "The International Competition Network: Its Past, Current and Future Role." *Minnesota Journal of Int'l Law* 20(2).

# Annex 1: Summary Table of Main Policy Options

Policy Option	The Current Situation	What Needs to Change
<b>Improving the international competition ecosystem to reinforce the international trade agenda</b>		
<b>1. Intensify multidimensional awareness raising regarding: (i) the type and impact of current anticompetitive practices; and (ii) the mutually reinforcing objectives and interconnections of the trade and competition policy agendas.</b>	<p>The number of national competition agencies has grown significantly over the past two decades, as the economic interconnectedness of countries worldwide has risen.</p>	<p>Awareness on the interface between competition and trade policy should be advanced at an international, regional, and national level and in a relevant fora such as the ICN, UNCTAD, OECD, and (when feasible) the WTO.</p>
	<p>Global value chains mean that businesses often operate across borders. Many competition cases today have an international dimension, in which multiple authorities investigate the same matter. This means that the risk of inconsistency of antitrust decisions with a negative impact on trade and investment flows has also risen.</p>	<p>To better inform the debate among policy-makers and in academic circles, develop an independent data and information platform to collect, organize, and disseminate information about government and private actions that affect the well functioning of markets with an international dimension.</p>
	<p>There is a risk that competition law can be employed as a tool of discrimination or market exclusion.</p> <p>In order to minimize the distortive effects of competition law and enforcement on trade flows, several enhancements in the competition policy related ecosystem are required.</p>	<p>Such a platform could also empower civil society, the media, and other relevant stakeholders by providing them with data and analyses, enabling them to scrutinize the decisions of national and international authorities and businesses.</p>
<b>2. Enhance competition policy coordination and collaboration at the international level.</b>	<p>International cooperation/coordination in competition policy has become ever more important, as competition agencies increasingly review multi-jurisdictional mergers and investigate conduct that spills across borders.</p>	<p><b>Step 1:</b> Stronger recognition of the need for an enhanced, sustained, and consolidated approach to informal international interactions:</p> <p>ICN harnesses OECD's technical capacities and its own networking capabilities to develop and strengthen recommendations and best practices in those areas that need further development.</p> <p>ICN develops a "model" advocacy strategy aimed at assisting younger competition agencies to press lawmakers to change the existing legal frameworks as necessary to comply with best practices.</p> <p>ICN, drawing on the comparative advantages of UNCTAD, provides technical assistance to implement internationally recommended practices.</p>
	<p>To reduce the risk and cost of potentially inconsistent antitrust decisions improved coordination mechanisms should be considered.</p>	

Policy Option	The Current Situation	What Needs to Change
	<p>As a supranational authority is out of reach, this implies adopting an incremental approach, using the institutional structures and instruments that already exist to optimize cooperation and collaboration step by step.</p>	<p><b>Step 2:</b> Strengthen voluntary international joint investigation and decision-making on multi-jurisdictional mergers:</p> <p>International cooperation and coordination could focus on multi-jurisdictional mergers as the most important source of potentially inconsistent competition authority decisions. Experienced competition agencies could work more effectively together by voluntarily collaborating in joint investigation and enforcement.</p> <p>A single coordinating authority for certain merger investigation could be nominated. The role of this authority would be limited to the collection of information and coordinating activities among investigating authorities in the jurisdictions of relevance</p> <p>ICN could provide a forum for the identification of a coordinator or lead authority in such multi-jurisdictional cases. This mechanism of coordination could also be applied for international cartel and unilateral conduct cases that have multi-jurisdictional effects.</p> <p>A useful complement to such a system of international cooperation in enforcement would be domestic legislation allowing for recognition of foreign competition decisions.</p>
<p><b>3. Work towards bilateral and regional dispute resolution and appeal mechanisms.</b></p>	<p>Competition policy related provisions in FTAs have largely been exempt from the dispute settlement mechanism of these regional agreements.</p> <p>A multilateral dispute resolution mechanism might not be feasible in the medium term. However, the inclusion of such mechanisms in bilateral and regional FTAs could present an opportunity to experiment and then further explore multilaterally.</p>	<p>Two kinds of dispute settlement mechanisms could be envisaged:</p> <p>State-to-state dispute settlement mechanisms modelled on existing mechanisms established through FTAs for other areas of trade policy; and</p> <p>Mechanisms allowing private companies concerned by individual decisions to seek redress at the international level. These would fulfil different functions and consequently be subject to different rules and limitations.</p> <p>These dispute resolution and appeal mechanisms would enable a gradual narrowing of divergences, reducing the costs associated with the current lack of harmonization in laws and decision-making in competition matters.</p>

Policy Option	The Current Situation	What Needs to Change
<b>4. Promote convergence in competition regimes through peer reviews.</b>	<p>There is a gradual convergence in competition enforcement procedures and methodologies of analysis among antitrust agencies across countries.</p> <p>Peer reviews are a powerful instrument to assess competition law and policy. The reviews undertaken within the frameworks of the OECD and UNCTAD contribute to achieve further international convergence.</p>	<p>It would be worth considering the introduction of peer reviews in FTAs as a mechanism to evaluate competition decisions in member jurisdictions.</p> <p>The conclusions and recommendations of such in-depth reviews should be public, even discussed in legislatures. It would also be advisable to make public the peer review process.</p>

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#### Applying competition policy to optimize current international trade frameworks

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<b>5. Enhance the role of competition policy in informing trade measures.</b>	<p>Current international trade frameworks allow for a certain degree of trade protectionism.</p> <p>Attempts to create a multilateral, legally binding competition policy framework complementing current trade policy instruments at the WTO have not materialized.</p>	<p>Develop a different approach to the use of competition policy at a national level to improve the market efficiency effect of the most important trade decisions. This implies greater empowerment of competition authorities.</p> <p>Adopt a more proactive <i>ex ante</i> approach in which national competition authorities evaluate, based on competition merits, any decision related to antidumping, tariff modification, government procurement, SPS, TBT, foreign direct investment and services regulation. The authority would then emit a proposal in each case following consultation with all affected parties.</p>
<b>6. Ensure competitive neutrality.</b>	<p>The increasing presence of state-owned enterprises (SOEs) in the world economy presents particular challenges for competition, trade, and investment policies.</p> <p>The main concerns relate to ensuring a level playing field between privately and state-owned companies in view of the advantages that SOEs may have in tax treatment, financing, and regulatory application. This creates market uncertainty and affects international flows of trade and investment.</p>	<p>Competition policy authorities should assess the current regulatory framework for SOEs in order to issue a public recommendation on the set of competitive neutrality principles of relevance.</p> <p>The increasing concern about the international activities of SOEs creates scope for an international agreement that could define some key principles to ensure competitive neutrality both in cross-border and domestic regulation of SOEs.</p> <p>The TPP Agreement may offer future insights as it has a chapter covering SOEs and designated monopolies. The importance given to the subject of SOEs and monopolies in the TPP highlights the significance of these topics for future deliberations on global economic governance.</p>

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Policy Option	The Current Situation	What Needs to Change
<b>Harnessing the power of free trade agreements</b>		
<b>7. Harness the power of free trade agreements.</b>	<p>FTAs are important platforms for cooperation in competition enforcement. Nations across the world have drawn attention to incorporating competition provisions in FTAs (especially the US and EU). This trend has started to facilitate the necessary cooperation/coordination between national competition authorities when enforcing competition law.</p> <p>Competition provisions in FTAs range from ambiguous obligations (provisions that lay out in broad terms the obligation of promoting competition) through to deeper commitments on e.g.: adopting competition laws; addressing anticompetitive practices; establishing mechanisms to facilitate competition policy; and considering the impact of regulation on competition. They can also go further and define the design of competition regimes to be established in signatory countries, even determine which anticompetitive practices the signatory parties should address.</p>	<p>In addition to fostering further cooperation and convergence in enforcement matters, future or presently negotiated free trade and investment arrangements could act as a vehicle for incremental harmonization of competition laws and practices in the absence of an international agreement on these issues.</p> <p>To this end, the development of a model competition chapter for inclusion in FTAs would greatly facilitate the process.</p> <p>The model chapter should include enforcement provisions that would be developed by the ICN with the technical support of the OECD, covering abuse of market power, cartels, and mergers. Regarding the treatment of SOEs and designated monopolies, the development of a model text by the ICN under the principles of transparency and non-discrimination could be the way forward. The model chapter should also include competition advocacy provisions. The inclusion of provisions on procedural standards for competition law enforcement is also crucial to ensure that the decisions taken under the umbrella of the FTAs are fair, transparent, and effective.</p>

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# Maximizing the Opportunities of the Internet for International Trade

Policy Options Paper



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# Maximizing the Opportunities of the Internet for International Trade

Joshua P. Meltzer

on behalf of the E15 Expert Group on the Digital Economy

January 2016

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on the Digital Economy. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Joshua P. Meltzer was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, the policy recommendations should not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

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- Global Trade and Investment Architecture\*
- Global Value Chains
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# Abstract

The last decade has witnessed remarkable developments in the digital economy, creating new opportunities for cross-border trade and investment and the ongoing emergence of novel and disruptive businesses models. At the same time, the Internet is transforming how goods and services are produced, delivered, and consumed both domestically and internationally. The transformation in the character of cross-border trade in goods and services, which are increasingly embedded, is also resulting from global value chains, made possible by the flow of immense amounts of data across borders. This has given rise to a growing overlap between the trade regime and other areas of domestic regulatory intervention—notably with respect to privacy and security. The present paper examines the challenges and opportunities that growth of the digital economy creates for trade and development. It seeks to identify supportive trade policy measures to enhance the benefits of digitization globally as well as avenues to establish regulatory practices that permit cross-border data flows and improved regulatory

cooperation among countries. Following a discussion of the impact of the Internet on the nature of international trade and an overview of important regulatory and other barriers, the paper outlines recommendations on how policy-makers and interested stakeholders can address existing constraints and help create an enabling environment to realize the opportunities of the Internet and cross-border data flows for growing digital trade. The policy options are grouped under four categories: maximizing and updating WTO rules; negotiating a digital trade agreement; expanding and deepening regulatory cooperation on key related policy issues; and enhancing collaborative efforts between governments, the private sector, and civil society. The objective of this broad range of options is to gradually develop a comprehensive set of international trade rules and norms to ensure that the opportunities of the Internet for inclusive growth and development are exploited.

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Abbreviations	
APEC	Asia-Pacific Economic Cooperation
B2B	business-to-business
ECJ	European Court of Justice
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICT	information and communications technology
IoT	Internet of Things
IP	intellectual property
ISP	Internet service provider
IT	information technology
ITA	Information Technology Agreement
ITU	International Telecommunication Union
KORUS	Korea-US Free Trade Agreement
MFN	most favoured nation
MLAT	mutual legal assistance treaty
NGO	non-governmental organization
OECD	Organisation for Economic Co-operation and Development
R&D	research and development
RFID	radio frequency identification
SDGs	Sustainable Development Goals
SME	small and medium-sized enterprise
TFA	Trade Facilitation Agreement
TFP	total factor productivity
TPP	Trans-Pacific Partnership
TPRM	Trade Policy Review Mechanism
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USITC	United States International Trade Commission
WHO	World Health Organization
WTO	World Trade Organization

# Executive Summary

Growth in Internet access globally, often over mobile phones, is having a profound impact on economies and international trade. Economies are going digital as the Internet and the ability to move data globally have enabled the development of new and innovative businesses. Global supply chains are also made possible by the immense flow of data across private and public networks. The Internet is transforming how goods and services are used and delivered, as businesses offer online services (such as monitoring of equipment or data analysis of product use) in combination with goods, such that the services component is an increasingly significant share of the overall product value. Businesses are using the Internet to reach consumers globally, which is also driving international trade.

Statistics on the economic impact of the Internet and data flows on economic growth and international trade are limited. However, modelling and empirical studies all point towards a strong influence of the Internet on economic growth and trade. For instance, the World Bank has found that a 10% increase in broadband penetration results in a 1.38% rise in economic growth in developing countries and 1.21% in developed countries. The US International Trade Commission has further found that the Internet has boosted US employment by up to 1.8%. The Internet is also creating opportunities for new and disruptive businesses (e.g. Uber and taxis), which are shifting employment patterns in some industries.

Traditional businesses are increasingly where the value and impact of the Internet on economic growth and trade is being realized. By some estimates, 90% of the US\$16.5 trillion e-commerce market globally is between businesses. This includes using the Internet to manage supply chains, access inputs online such as software, utilize cloud technologies, and source professional services. Businesses are also using the Internet to grow R&D and design practices globally, combining greater access to information and data to drive innovation. The Internet of Things is another developing area that is providing increasing amounts of data that businesses are using to improve productivity and competitiveness.

Consumer use of the Internet is also growing globally. Using Internet platforms and other services such as eBay, Alibaba, Etsy, or Google Search, consumers can search for and purchase goods—often from geographically dispersed small and medium-sized enterprises (SMEs). This is opening up new possibilities for SMEs to sell their products online, engage in international trade, and become part of the global economy in ways that were not previously possible. The Internet is also overcoming barriers that previously made it costly for many businesses in developing countries to engage in international trade. For example, the ability to deliver digital products online can help overcome traditional trade costs arising from poor infrastructure, inefficient customs procedures, and distance to large consumer markets.

Against this backdrop, the mandate of the Expert Group on the Digital Economy, convened by ICTSD in partnership with the World Economic Forum as part of the E15 Initiative, was to examine the challenges and opportunities that growth of the digital economy creates for trade and development, and identify constraints and possible improvements in the global trade system to enhance benefits from the digital economy. A set of policy options for improved governance of international trade in a digital world emerged from this expert dialogue process.

## An Enabling Environment for Digital Trade

Realizing the opportunities of the Internet and cross-border data flows for economic growth and international trade will require an enabling environment that has three elements to it.

The first is the need for regulations that give businesses and consumers the confidence to use the Internet to engage in cross-border transactions. This includes greater certainty as to the application of consumer protection laws to digital trade, expanding access to dispute settlement mechanisms to settle disputes arising out of digital trade, enabling logistics networks to deal with the particular demands of digital trade (such as trade in low value goods), access to international payment mechanisms, and ensuring that governments and companies have the tools to protect the security of data online.

A second set of commitments are further necessary to ensure that online information can be accessed and data can flow freely across borders, recognizing that this will require security and regulatory oversight to engender confidence that confidential and private information will be protected. Governments should agree not to apply

regulations such as data localization laws that require data to be kept within a particular jurisdiction. Governments should also reconsider policies that limit Internet access to some foreign businesses in order to shield domestic players from competition—a form of digital protectionism.

The third element concerns the need for cooperation to address the regulatory externalities that can arise from digital trade and the incentives this can create for governments to restrict cross-border data flows. For example, the EU prevents the transfer of personal data to third countries that do not have an “adequate” level of privacy protection. Interoperable regulatory frameworks such as the APEC Cross-Border Privacy Rules can be effective in protecting privacy on a cooperative basis with broader international coverage, while ensuring that data can continue to cross borders.

## Policy Options

The following are the report’s key policy options, grouped under four categories, which seek to cover as much ground as possible in relation to the challenges identified above. The options include an indicative short to long-term time horizon for possible implementation, depending on their level of ambition, and they all call on governments, the private sector, and civil society to engage proactively in relevant fora.

### *Maximize and Update WTO Rules*

(i) Implement and consider expanding the WTO Trade Facilitation Agreement to support digital trade; (ii) make permanent the moratorium on customs duties on electronic transmissions; (iii) empower the WTO to further conceptualize how the digital economy can be supported in both developing and developed economies and expand the WTO’s information functions on digital trade; (iv) better understand the scope for WTO law to support digital trade by convening a working group to determine the extent that digital trade needs are covered under the existing WTO rules and alternative approaches going forward; (v) conclude and then expand the International Technology Agreement; (vi) update the WTO Telecoms Reference Paper to ensure competition over the Internet as well as traditional networks; and (vii) clarify the application of WTO members’ GATS commitments on digital trade.

### *Negotiate a Digital Trade Agreement*

(i) Negotiate digital trade rules in the Transatlantic Trade and Investment Partnership and the Trade in Services Agreement and develop at the WTO a plurilateral digital trade agreement; (ii) expand services market access commitments that can be delivered online; (iii) commit to allowing the free flow of data across borders subject to an exceptions provision based on GATS Article XIV; (iv) commit to not require data localization; and (v) promote balanced intellectual property systems by including effective enforcement rules as well as limitations and exceptions, and develop as safeguards appropriate protections from intermediary liability.

### *Expand and Deepen Regulatory Cooperation on Digital Trade Issues*

(i) Develop regulatory cooperation in areas affected by digital trade with priority given to online privacy, consumer protection across borders, and rules for online contract formation and enforcement; (ii) improve online financial payment options; and (iii) develop a dispute settlement mechanism for digital trade.

### *Governments, Business, and NGOs Working Together to Support Digital Trade*

(i) Improve data gathering and metrics concerning digital trade; (ii) enhance government / private sector cooperation on digital trade issues, including in areas such as developing a dispute settlement mechanism, improving online security, and further developing principles that can help drive a global consensus on the importance of digital trade; and (iii) expand financing of digital infrastructure in developing countries.

## Next Steps

The Internet and global data flows are creating new opportunities for more inclusive growth and employment. Yet, the current set of international trade and investment rules and norms navigate between competing goals and do not adequately support an open Internet or the flow of data across borders. This report provides a broad range of recommendations for immediate and long-term action by governments, businesses, and NGOs to engage in new forms of regulatory cooperation and the sharing of experience and knowledge. The objective is to develop a comprehensive set of international trade rules and norms to ensure that the opportunities of the Internet and global data flows are fully realized.

# 1. What is Digital Trade?

The last decade has witnessed remarkable developments in the digital economy which are creating new opportunities for cross-border trade and investment and the emergence of new businesses—large and small—often in unexpected sectors or regions, and with new business models. The consequences of access to the Internet, data, mobility, and digitization are also having profound impacts on manufacturing and services delivery, production, and use. The integration of digital elements are giving rise to issues of characterization itself: goods once clearly thought to be “manufactured goods” can now embed or utilize a digital dimension that provides essential value-added to the product and transforms them into one that is both a good and a service, however recognized under international tariff nomenclatures.

The transformation in the character of cross-border trade is also resulting from global value chains of goods and services, which is made possible by the flow of immense amounts of data across borders on both public and private networks. Cross-border data flows are both essential to global value chains and can be a by-product of it. This has, in turn, given rise to the intersection of the trade regime with still more areas of economic and regulatory policy— notably with respect to data privacy and security policies, all of which can now have profound implications for the future of the international trade regime. As many have observed, the Internet is both part of the global commons and part of every nation’s sovereign jurisdiction. Policies that implicate its use (especially around data) can therefore have significant externalities. This recognition is not new— it has been fundamental to economic globalization and the development of the rules of the international trading system overall. Indeed, trade rules have increasingly shifted focus from border measures to internal measures because of the recognition that those internal practices have profound cross-border implications. Today, nowhere is this more important than with respect to digital trade and the regulation of data and information.

For this discussion, a focus on digital trade includes as a fundamental characteristic the use of the Internet to search, purchase, sell, and deliver a good or service across borders. A more expansive lens could also speak to how Internet access and cross-border data flows enable digital trade.

The mandate of the Expert Group on the Digital Economy, convened by ICTSD in partnership with the World Economic Forum as part of the E15 Initiative, was threefold. First, examine the challenges and opportunities that growth of the digital economy creates for trade and development. Second, identify constraints and areas for improvement in the global trade system to enhance benefits from the digital economy. Third, propose specific options for governance of international trade in a digital economy. In order to accomplish its mandate, the Group sought to address key questions. What is the nature and extent of digitization of economies across sectors and jurisdictions? How are consumers and businesses in the developing world accessing and using the Internet and what does this suggest for supportive policy measures? How should the key technical, infrastructural, and policy barriers that have implications for digital trade be addressed? How can we establish regulatory practices that permit cross-border data flows and improved regulatory cooperation among countries?

The first three parts of the background section below discuss the importance of Internet access and cross-border data flows for trade. These subsections provide an overview of growth in Internet access and how it is being used to grow digital trade. The opportunities of the Internet and data flows for small and medium-sized enterprises (SMEs) and developing countries are also discussed. Subsection 2.4 examines how the Internet is changing the nature of international trade, from the growing services share of trade to increasing trade in low value goods as companies use Internet platforms to sell such goods globally. Subsections 2.5 and 2.6 analyse the barriers to digital trade. Section 3 then lays out policy recommendations for how governments, firms, individuals, and non-governmental organizations (NGOs) can address these barriers and help create an enabling environment to realize the opportunities of the Internet and cross-border data flows for growing digital trade.

# 2. Enabling Digital Trade and Data Flows

## 2.1. Internet Expansion and its Impact on International Trade

### 2.1.1. The globalization of the Internet

One of the key drivers of the growth in digital trade has been the expansion globally of Internet access. By the end of 2015, 3.2 billion people are expected to be online, with 2 billion of these in developing countries (ITU 2015). However, this also means that 4 billion people will remain offline and 90% are in the developing world.

### 2.1.2. The mobile Internet

It is also the case that Internet access is increasingly happening over mobile devices, making access to such devices inseparable from the challenge of expanding Internet access. Indeed, mobile phones are now the main way that people in developing countries get online. Challenges to expanding such Internet access include the costs of Internet-enabled smartphones and the costs of mobile broadband plans. For instance, by 2018, 54% of mobile devices in the developing world will be “smart” compared with 93% of US mobile devices (Cisco 2014, 9).

### 2.1.3. Quantifying the impact of the Internet on international trade, economic growth, and employment

There is only limited data on the importance of the Internet and cross-border data flows for digital trade. One reason is that public trade data does not distinguish between whether goods and services are delivered offline or online. The impact of the Internet on digital trade is also a function of the digitization of economies broadly, which has made separating out the impact of the Internet on trade (and GDP) a complex task.

Notwithstanding this limitation, some economic modelling has been done that seeks to quantify the relationship between Internet access, economic growth, and trade. A World Bank study found that a 10% increase in broadband penetration resulted in a 1.38% increase in growth in developing countries and a 1.21% increase in growth in developed countries (Qiang and Rossotto 2009). In terms of the impact of the Internet on trade, one study concludes that a 10% increase in Internet access leads to a 0.2% increase in exports (Freund and Weinhold 2004). Other studies using more recent data find even stronger impacts of Internet use on trade (Meijers 2014).

It is also the case that trade can increase country use of information technology (IT) and the Internet (Onyeiwu 2002). One way is through imports of advanced products from developed countries that can provide learning opportunities that facilitate greater use of new technology.

The digitization of economies also means that the Internet can affect trade through its impact on productivity, which in turn increases the competitiveness of these businesses domestically and globally (Bernard et al. 2007). For instance, use of the Internet to collect data and analyse it can improve firm productivity by making supply chains more efficient, improving distribution and transport schedules. Indeed, much of the strong productivity growth in the US in the mid-1990s through to the mid-2000s has been attributed to strong investment in information and communications technology (ICT) (Grossman and Helpman 1991, Bailey 2002). A recent study of EU firms also found that engaging in e-commerce increases labour productivity—and that e-commerce had accounted for 17% of EU labour productivity growth between 2003–2010 (Falk and Hagsten 2015). A 2014 US International Trade Commission (USITC) calculated the productivity gains from the Internet by surveying US businesses and converting the results into an economic model. The USITC found that the productivity gains from the Internet have increased US real GDP by 3.4–3.5% (USITC 2014).

Such potential for the Internet and data to increase productivity needs to be better understood given that since 2007, most countries have been experiencing low rates of growth in total factor productivity (TFP) (Van Ark and Erumban 2015). There are various explanations for why the impact of the Internet and data on productivity is not been reflected in national productivity statistics. One reason for this is that the measurement of TFP fails to capture the positive network externalities from IT investment and Internet use (Chou et al. 2014, 292).

The Internet can also benefit employment, although this is a much debated subject. The Internet is creating jobs in areas such as IT, services, information-related products, and software (Terzia 2011). The Internet can be used to improve the labour market by streamlining job search capabilities, more effectively matching employers and employees. The USITC found that the Internet had increased US employment up to 1.8% (USITC 2014, 71).

The Internet is also disrupting industries and in the process shifting employment patterns in some sectors. For example, hotels are being disrupted by Airbnb, taxis by Uber, and retail by Amazon. Yet, a McKinsey report finds that for every job destroyed by the Internet, it has also contributed to the creation of 2.6 jobs (McKinsey 2011b).

The Internet is also affecting the demand for certain skills. Demand for those with skills to manage information and exploit data is growing, with less demand for low and middle-wage occupations and skills (Bresnahan 1999). Such employment impacts underline the need for policies to help those marginalized by these developments.

## 2.2. The Trade Implications of a Global Internet

The following discusses the ways that Internet access and cross-border data flows can affect international trade.

### 2.2.1. Big data and digital trade

The growth in the collection of data and the ability to transfer it across borders is allowing for the aggregation of big data. Combined with data analytics, big data is spurring new business models and forms of international trade. For instance, Facebook, Airbnb, Alibaba, and Mercado Libre are global companies that rely on the ability to collect data and transfer it globally to provide services to customers; creating “big data” that can be analysed to create new business opportunities. These data-driven opportunities also extend into areas such as health care—which McKinsey (2011a) estimates could be used to reduce US national healthcare expenditures by about 8%. According to a recent OECD (2015) report, big data has the potential to be a key driver of innovation, productivity growth, and economic competitiveness.

The Internet and ability to move data globally has also been an important driver of global value chains (Backer 2014). This has included using data to manage globally disperse production units, to enable global collaboration on design and R&D and to run transportation management systems that connect supply chains with logistics networks.

The Internet of Things (IoT) is another area that will be a new source of data and where the opportunities are only beginning to be realized. For example, the value of machine-to-machine IoT is expected to grow from US\$44 billion in 2011 to \$290 billion in 2017 (Tsai et al. 2014). This includes in areas such as sensors in factories to increase the efficiency of operations and use of radio frequency identification (RFID) technology to track goods and manage distribution centres. In addition, the IoT is likely to largely be a business-to-business phenomenon—McKinsey estimates that approximately 70% of the value from the IoT will arise from business-to-business use (Bughin et al. 2015).

The IoT will generate a large amount of data. Collecting this data and turning it into knowledge will be a key feature of the IoT (Tsai et al. 2014). This will require the ability to collect data in one country, aggregate it with data from other countries, and to analyse it in a third country (creating so-called big data)—all of which will entail the ability to move data across borders.

### Box 1: Improving the Global Delivery of Renewable Energy

Vestas—the Danish wind turbine company—collects data from its globally situated turbines and analyses it in Denmark to better understand the impact of temperatures, wind speeds, and air pressure on turbine performance, and to make precise service and maintenance schedules. A system of global data also allows Vestas to manage its global supply chains, including by alerting warehouses of needed parts that can then be shipped to the turbines in need of repair.

### 2.2.2. Business-to-business Internet commerce

Significant economic gains are arising from the Internet’s impact on transactions between businesses—commonly referred to as B2B transactions. In 2013, B2B e-commerce is estimated to have accounted for 90% of the total \$16.5 trillion of e-commerce (UNCTAD 2015). This includes using the Internet to access software and business service providers and to conduct market research in potential export destinations. Businesses are also using cloud computing to access data storage, processing power, and software applications as services, reducing IT infrastructure and services costs which improve productivity (Liebenau et al. 2012).

Access to business inputs online can itself be a form of trade when services are supplied from businesses situated globally. Such access by businesses can also indirectly grow trade when it leads to increased productivity, thereby making businesses more competitive domestically and in overseas markets. According to an OECD study, a 1% increase in the importation of business services is associated with a higher export share of 0.3% (Gonzales et al. 2012, 186).

Access to information globally is also creating new opportunities for collaborative R&D and design, which supports new business outcomes and can enable global commerce.

### 2.2.3. Access to global customers

The expansion of the Internet globally means that businesses can reach overseas customers and sell products online. Goods can be searched for and purchased online but delivered offline. Other digital products that are searched for and purchased online can also increasingly be delivered online. The Internet is also enabling businesses to deliver goods in more efficient and cost effective ways, using RFID technology to track and trace the movement of goods from suppliers to customers in real time.

The growth of Internet commerce appears to be amplified by the growth of a middle class. According to one estimate, cross-border online shopping was worth \$105 billion in 2013 (PayPal 2013). By 2017, over 45% of the world is expected to be engaging in online commerce (Statista Dossier 2014, 41).

The Internet has also led to a range of innovative business models that rely on a mix of advertising, as well as free or paid content. For example, Pandora receives fees for its steaming service, e-books are sold or rented online, games for mobile phones rely on app purchases, subscriptions and ad, and software can be purchased or subscribed (Lambrecht et al. 2014). As such content is sold globally, cross-border data flows are an increasingly necessarily enabler of such transactions.

#### 2.2.4. The opportunities for small and medium-sized enterprises

Perhaps somewhat surprisingly, the global nature of the Internet is creating new opportunities not only for established and larger firms but also for SMEs to engage in international trade (USITC 2013a, 2–3). For example, 95% of SMEs in the US using eBay to sell goods and services are engaged in export to customers in more than 4 continents—compared with less than 5% of US businesses that export offline. And 74% of these SMEs are still exporting after 3 years, compared with 15% of offline exporters (eBay 2015).

In addition, nearly 60% of views of YouTube channels come from outside the home country of a channel’s owner and 80% of YouTube views come from outside the US (YouTube 2015). These cross-border views of videos can translate into real economic gains for SMEs. For example, companies often see sales rise after they post videos of their product, and can use online videos as a launch pad to build real-world apps, products, and services for a global customer base. This is important because SMEs are the main drivers of employment and job creation across the world. SMEs that export are also more productive and pay higher wages (USITC 2010a).

The Internet provides various ways that SMEs can overcome traditional barriers to growth by reducing trade costs and allowing these businesses to serve overseas markets. For instance, a website gives SMEs an instant international presence without having to establish a physical presence overseas—often not an economic option for SMEs. Access online to cost effective business inputs is another important driver, such as online advertising and communication services, cloud computing, and access to critical knowledge and information on foreign markets (OECD 2009, USITC 2010b).

#### **Box 2: Growing Strawberries in India**

NEC from Japan uses the ability to transfer data globally to support greenhouse strawberry cultivation in India. Local growers measure and record the greenhouse environmental data, which is monitored remotely from Japan. Cultivation experts in Japan assess this data and provide advice and recommendations, promoting overall productivity enhancements.

Perhaps one of the more interesting phenomena that the Internet is revealing is that SMEs can specialize in specific tasks and use the Internet to deliver that service or as part of a global value chain (Grossman and Rossi-Hansberg 2006). For instance, NightHawk Radiology Services located in the US relies on broadband technology to employ radiologists in India and Australia to provide immediate diagnostic interpretation of CT images taken in American hospitals (USITC 2013b, 2–3).

#### 2.2.5. The opportunities for developing countries

Internet access provides a range of economic growth opportunities for developing countries, including through new opportunities for entrepreneurs and small businesses in these countries to engage in international trade. For instance, an UNCTAD (2015, 2) report recently found that: “Local e-commerce companies are rapidly appearing in developing countries, tailored to the needs and demands of local users.” For instance, African online retailer Jumia is expanding into Cameroon and Uganda, in addition to its existing operations in Cote-d’Ivoire, Egypt, Kenya, Morocco, and Nigeria.

B2B transactions will have a large impact in developing countries as well. Some of this will be direct forms of international trade, for instance when service suppliers in one jurisdiction provide services to companies in another, such as in the business services sector between India and the United States as one notable example.

Other forms include local B2B transactions that increase the efficiency and competitiveness of domestic businesses, making them more competitive domestically and in overseas markets.

The Internet can also improve access to finance for developing country businesses; thereby overcoming domestic capital markets constraints on growth. For example, crowdfunding platforms already exist in emerging markets such as Brazil and Colombia, and developing countries in sub-Saharan Africa (World Bank 2013a, 32). According to the World Bank, developing country businesses could use crowdfunding to mobilize up to \$96 billion by 2025 (Ibid, 43).

As is the case for business generally, the Internet can help developing country firms overcome the costs of engaging in international trade. Developing country businesses can also use the Internet to sell goods and services online, directly to the consumer or as part of a global value chain (Ibid, 72). This includes trade in digital products that can be delivered online and thereby overcome barriers such as inefficient customs procedures and poor transportation infrastructure that have made international trade too costly (Adlung and Soprana, 4–5).

Getting access to customers globally using Internet platforms is another way that businesses in developing countries use the Internet to engage in international trade. For example, China’s Taobao.com provides a mobile platform that coordinates all e-commerce needs along a value chain (Ibid, 74). A survey of business in developing

countries using the eBay platform found that over 95% of SMEs were engaged in export, and that 60–80% of these businesses survived their first year, compared to only 30–50% for offline exporters (eBay 2013).

### 2.3. How the Internet is Changing Trade

The Internet and the growth in digital trade will have a growing impact on the composition and delivery of trade. The following outlines some of the areas where it is already apparent that this is likely to happen.

#### 2.3.1. The growing importance of services trade

The Internet is increasing opportunities for trade in services. For example, professional services such as legal, engineering, and financial can now be provided online in part or in whole, depending on the nature of the service and the extent to which the domestic regulatory framework allows it to occur.

Digital trade is also blurring the distinction between goods and services. This is happening as goods are being traded as services, which are an increasingly important component of goods. For example, software has been typically distributed on a CD and therefore in the WTO context treated as a good, even though most of the value of the CD is in the software. Now that software can be delivered and updated online (often via the cloud), trade in software does not require goods to cross borders. This trend is also true for trade in books, movies and music—where trade in the physical form has been replaced by increasing amounts of cross-border movement of digital content.

The move from trade in goods to trade in services also has legal and policy consequences. Under the rules of the WTO, trade in goods and services are governed by different agreements—the General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS) respectively. While core non-discrimination principles of most-favoured-nation (MFN) treatment and national treatment are contained in both the GATT and the GATS, each agreement contains other important differences. For instance, the scope of coverage in the GATS is a function of scheduled commitments (so-called positive list) and it allows for exceptions to the MFN commitment and the national treatment requirement, which only apply to the specific liberalization commitments undertaken by the individual member. In contrast, the GATT MFN and national treatment commitments apply to all rules, regulations, and taxes affecting trade in goods. In addition, the level of market access liberalization in the GATS is generally less than that for goods in the GATT.

This can have specific meaningful consequences when it comes to a digital product, and the case law in this area is still at the early stage of development. For example, the importance of whether a digital product is classified as a good or service under the WTO was a key issue in

the *China Audiovisual* case. In that dispute, China argued that its trading rights commitments (which only apply to trade in goods) were not applicable as the measures being challenged regulated the content of films, which was a service.<sup>1</sup>

The form of delivery—be it as a good or as a service—can also have other consequences such as with respect to the collection of customs duties. For example, software delivered on a disk is subject to border duties while the same software delivered online through digitized delivery can avoid such duties.

#### 2.3.2. The impact of the Internet on the services value of goods

There are many and diverse commercial consequences of the Internet on goods and services and the relationship between the two. It has, for example, enabled growth in services that have now become part of goods. The technology component of some goods can fundamentally impact the value of the good. This is a form of what McKinsey refers to as digital wrappers—where digitization is enhancing the value of trade in goods (Manyika et al. 2015). For example, apps and geolocation devices are changing the business models of car manufacturers who need to conceive of their product more in terms of delivering transport solutions than simply as vehicles (Bughin et al. 2015). Or take RFID technology, which is being used to track the flows of goods and to drive significant improvements in logistics. According to one McKinsey report, Hewlett-Packard and BMW's use of RFID for managing global logistics networks reduced losses in transit by between 11–14% (Manyika et al. 2015, 37). To achieve these gains has required the ability to collect data globally and for it to be analysed in third countries in order to generate the knowledge that is used to improving logistics services.

#### Box 3: As Trucks Become Services

The Caterpillar 797F Mining Truck weighs 1.375 million pounds and can haul up to 400 tonnes of dirt. The value of this truck is increasingly reflected in the related services that Caterpillar offers. These include real-time data analytics on grading accuracy, load quantities, and quality of work, which can be used to minimize fuel costs and downtime, increasing productivity. Sensors that monitor tire pressure and utilization rates allow Caterpillar to determine when parts need to be replaced, reducing maintenance costs.

<sup>1</sup> WTO Appellate Body Decision, *China-Audiovisual Products*, WT/DS363/AB/R, para 15.

### 2.3.3. The implications of the Internet for domestic regulation

Digital trade can affect the capacity of domestic regulators to achieve their regulatory aims, for example in areas as diverse as consumer protection, financial stability, or health and safety. This can have positive and negative consequences. For example, a study by the WHO (2011) noted with concern that online purchases of pharmaceutical products allowed consumers to avoid domestic health and safety regulations such as the requirement to obtain a doctor's prescription.

Another area where digital trade has important impacts on regulatory goals is in the area of privacy. In the absence of a mechanism to manage differences in privacy regulation, the exporting country has an incentive to impose restrictions on the movement of personal data. This is in effect what has happened in the EU where the EU Privacy Directive prohibits the transfer of personal data to countries that do not have an "adequate" level of protection. The impact of EU privacy laws on cross-border data flows has been further complicated by a recent ruling by the European Court of Justice, which has invalidated the European Commission's adequacy decision under the US-EU Safe Harbour Framework.<sup>2</sup>

Managing the interface of privacy laws and data transfers matters for digital trade because a lot of the data that is being collected by online businesses in the process of exporting services is individual data. Personal data is any data that can be used to identify a person. Moreover, even anonymized data when combined with data analytics can be used to personally identify an individual.

Conversely, confidence in the EU to further open its market to digital trade will depend, in part, on how this affects its ability to enforce its domestic privacy laws. It is becoming increasingly apparent that the failure to address the regulatory externalities caused by digital trade will create incentives for governments to respond by restricting such trade either directly or indirectly (Mattoo 2015).

Another approach to dealing with the interaction between global data flows and protecting privacy is the APEC Privacy Framework, a set of principles to guide APEC members and businesses on privacy issues. APEC does not require or expect countries to adopt top-down privacy laws and instead emphasize flexibility in its implementation that could include in addition to legislation, industry self-regulation (APEC 2015, preamble 1).

### 2.3.4. Digital trade and balanced intellectual property rules

In the context of international trade, it is critical that countries approach intellectual property (IP) policy in a balanced manner.

As the OECD has noted, IP policy "can discourage innovation if pursued too strongly or too weakly." For example, "in an era of routine copying of text, data and images, copyright law may hinder the emergence of new kinds of Internet-based firms. It may also make scientists and other researchers reluctant to use text- and data-mining techniques" (OECD 2013, 49). Finding the right balance between IP protection that encourages innovation and maintaining competition and the diffusion of ideas over the Internet is important.

The Trans-Pacific Partnership (TPP) appears to take a positive first step in the direction of balanced IP. The TPP promotes effective enforcement of IP rights but also asks parties to "achieve an appropriate balance" in their copyright systems through limitations and exceptions based in purposes such as "criticism; comment; news reporting; teaching, scholarship, research, and other similar purposes."<sup>3</sup>

Initial research shows that when a country adopts balanced copyright rules and other limitations such as fair use, companies in these countries generate higher revenues, create more jobs, and spend more on R&D, when compared to countries with more closed lists of copyright exceptions (Gilbert 2015, Palmedo 2015).

In addition to ensuring that trade agreements promote balanced copyright, it can also be helpful to digital trade for agreements to tackle the issue of intermediary liability—whether Internet service providers (ISPs) should be liable for hosting or transferring content posted by users.

Legislators in the US, for example, made a series of deliberate regulatory choices that led to the rise of the modern Internet. The Communications Decency Act of 1996 exempted intermediaries (e.g. Prodigy, eBay, YouTube, Facebook, Twitter) for the speech of their users. The Digital Millennium Copyright Act of 1998 created a separate safe harbour for intermediaries when they are made aware of copyright-infringing content posted by their users and they take it down.

The US has now included appropriate protections on intermediary liability in the intellectual property context—modelled on existing national safe harbours—as part of several bilateral free trade agreements (FTAs) and the TPP. This is important, as many countries do not have in place intermediary liability regimes.

<sup>2</sup> Maximilian Schrems v. Data Protection Authority, Court of Justice of the European Union, C-362/14.

<sup>3</sup> Trans-Pacific Partnership Intellectual Property Chapter, Article 18.66.

Similar protections from liability for non-IP content posted by users (e.g. defamation and other speech-related harms) should also be included in trade agreements.

### 2.3.5. Digital trade in low value goods

Digital trade is also changing the composition of goods trade. Pre-Internet, it was often not commercially viable to export low value goods. As a result, large companies exporting goods in bulk have dominated international trade. The development of Internet platforms that have connected business and consumers globally has opened up new opportunities for trade (often by SMEs) in individual goods of relatively low value. That such trade in low value goods is growing is suggested by data showing that the global delivery of small packets, parcels, and packages increased by 48% between 2011 and 2014.

Certainly, costs remain for such exporters, and these “barriers” (discussed in more detail below) will need to be addressed to realize the opportunities created by the Internet to for this digital trade to grow.

### 2.4. Increase Internet Access

Recognizing that digitization and the Internet is having profound consequences for the movement of goods and services, with considerable domestic regulatory and policy consequences, the paper outlines in what follows the key challenges and barriers to realizing the opportunities of the Internet for digital trade.

A threshold issue that needs to be considered by the global policy community is the differential access that exists around the world to the Internet itself. This digital divide limits the opportunities of the Internet for digital trade and, even more profoundly, economic development.

The role of Internet access as a development outcome is recognized in the post-2015 Sustainable Development Goals (SDGs). For instance, the goals of increasing access to resilient infrastructure, promoting inclusive and sustainable industrialization, and fostering innovation are all enabled by Internet access. Therefore, the SDGs also include the goal of providing universal and affordable access to the Internet in least developed countries by 2020. Access to ICT is also seen as necessary to achieve other SDGs, including as a means for achieving the goals of gender equality and empowering women and girls.

While Internet access has grown exponentially over the last 20 years, the rate of growth has slowed. This is because the easiest opportunities to increase Internet access have been realized, and, increasingly, those without Internet access are harder to reach. For example, approximately 75% of those without Internet access are concentrated in 20 developing countries, and those without access in these countries tend to be the poorest, often elderly and rural populations. The challenges of getting these people online will require innovative approaches, and Internet companies such as Google, Microsoft, and Amazon are already trialling new methods to expand Internet access, including through balloons and drones. But dealing with the challenges of

poverty, illiteracy, and lack of infrastructure in rural areas will need to be part of the solution.

The cost of using the Internet also affects use and therefore the potential of poorer businesses and consumers, in particular, to use the Internet for international trade. Average monthly fixed broadband prices are three times higher in developing countries than in developed countries, and mobile broadband prices are twice as expensive in developing countries, than in developed countries (ITU 2015).

There are various factors affecting the cost of Internet access, including geography, population, and the quality of existing infrastructure. Whether there is competition in the telecoms market is another important determinant of cost and one that is amenable to being addressed through trade policy (discussed below).

### 2.5. An Enabling Environment for Digital Trade

It is also the case that merely increasing Internet access cannot alone realize the opportunities of the Internet for international trade. The ability for businesses and consumers to use the Internet requires an enabling environment—a set of laws and institutions that support the process of buying, paying, and delivering digital products.

Providing the right regulatory environment to support digital trade is one of the most significant challenges to maximizing the opportunities of the Internet for digital trade. This is often not a simple question of more or less regulation but of establishing the right regulatory mix. The types of regulations and institutions that form an enabling environment for digital trade can be categorized into three buckets.

- The first are those regulations and institutions that must be present to give businesses and consumers the confidence to use the Internet to make cross-border transactions. This includes a cost-effective and timely dispute settlement mechanism; financial payment mechanisms; consumer protection laws; and protection of personal information. For digital products that are delivered offline, the ability for goods (which might be of low value) to avoid customs duties and be delivered rapidly is essential.
- A second set of regulations affects the types of information that is available online and the ability to transfer data across borders. This requires having in place rules and norms that limit (or prohibit) the use of regulations that reduce the openness of the Internet. Included here are data localization laws and regulations which restrict access to Internet content in order to support domestic competitors.
- A third set of regulatory issues arises from the need to address the impact of regulatory externalities caused by digital trade and the incentive this creates to restrict cross-border data flows. What is most often required here is regulatory cooperation among countries to address these externalities. The following goes into these challenges in more detail.

## 2.5.1. Factors affecting confidence in using the Internet for digital trade

### 2.5.1.1. Lack of harmonization/mutual recognition among jurisdictions that undermines trust

Trust is a key determinant of whether businesses and consumers are willing to engage in online commerce. One reason for lack of trust in digital trade is due to a shortage of reliable information about the seller. This is particularly acute for services exports because the buyer cannot visit the seller and the production and consumption of the service often takes place simultaneously. Rating systems are seeking to overcome these issues, but they are company specific and are not globally interoperable.

Regulatory differences between countries also increase the costs of assessing the quality and safety of the service. Such costs are compounded by a lack of interoperability between consumer protection laws across countries. The lack of a common approach to contract formation online also increases the risk of digital trade.

### 2.5.1.2. Inadequate mechanisms to settle cross-border disputes for low value goods

The impact of the Internet on international trade and in particular the expected increase in trade in low value goods raises new challenges for disputes settlement. Yet there is no global dispute settlement mechanism capable of resolving digital trade disputes in a timely or cost-effective way.

For one, resorting to domestic courts to address digital trade disputes will raise uncertainty as to which court has jurisdiction and whether judgements can be effectively enforced in another jurisdiction. In addition, resorting to domestic courts to resolve disputes over low value goods will often be impractical.

Neither is the WTO dispute settlement mechanism suitable. In many cases, digital disputes will not involve government measures that can be the subject of WTO dispute settlement. Even where there are measures that could be subject to WTO dispute settlement, the time taken to resolve a WTO dispute (usually around three years), the absence of damages as a remedy, and the lengthy compliance review process make the WTO an ineffective forum, particularly for SMEs and trade in lower value goods.

The absence of cost-effective and timely mechanisms for resolving disputes arising from online international transactions increases the risk of digital trade. In response, eBay has created its own dispute settlement process for transactions over its platform. Using this system, eBay resolves more than 60 million online disputes annually, most of them over low value goods (Rule and Nagarajan 2010, 5), highlighting the demand for such a system.

### 2.5.1.3. Security concerns

Security of data online is another concern that can undermine willingness to engage in digital trade. There are two aspects to this. One is the security of data from criminal activity. This can include everything from malware to ransomware that affects personal computers and mobile devices through to access by criminals to personal data stored by businesses engaged in online commerce (Cisco 2015). All of these threats increase the risk to consumers of providing the types of data required for digital trade to grow.

Another aspect to the national security issue is government use of the Internet to collect personal data for surveillance purposes. This issue has become particularly acute in the EU following the Snowden leaks about National Security Agency (NSA) use of private servers to collect data on non-US citizens. However, broad government surveillance powers are not limited to the US government and exist in many countries. Where people are particularly concerned about such government activity it can lead them to avoiding the Internet, including for digital trade purposes. Countries should review these regimes and require that surveillance (both domestic and foreign) be judicially authorized except in narrow cases such as an immediate emergency, and that it be limited in scope and duration.

In addition, the Snowden leaks have spurred commercial responses—such as Deutsche Telekom's efforts to build a so-called German cloud, which it claims will be free from US government surveillance as well as proposals to keep EU data within the Schengen Area. In such ways, consumer and business responses to government use of the Internet for national security purposes can have implications for digital trade. The Snowden leaks are estimated to cost the US cloud computing firms up to \$35 billion in lost revenue (Castro 2013).

### 2.5.1.4. Inadequate logistics networks

According to the World Bank (2013b, 34), the competitiveness of many countries is negatively affected by high trade costs arising from poor transport and logistics. This includes infrastructure such as ports, roads, airports, and ICT as well as logistics such as express postal services (World Bank 2012, 27–28). A World Economic Forum (2013) report estimates that improving customs administration and transport services could increase global GDP by up to \$2.6 trillion (World Economic Forum 2013).

Access to efficient logistics networks is also needed if businesses are going to effectively participate in global supply chains. Flows of goods among developing countries participating in regional supply chains are particularly sensitive to logistics costs (Saslavsky and Shepherd 2012, 18).

Internet-enabled trade in low value goods make logistic issues particularly important and raises some new questions. For instance, trade in high quantities of small value goods requires efficient customs processes and makes seamless linking between international and domestic delivery services particularly important, as these costs

can quickly make trade in low value goods unnecessarily complicated and often uneconomical.

A further challenge here is for trade logistics systems to be capable of handling returns—a distinguishing feature of the domestic e-commerce experience that will need to be replicated internationally if consumers are to fully engage in Internet-enabled international trade.

#### 2.5.1.5. Access to international payment mechanisms

Access to international payments mechanisms is a crucial underpinning of all forms of digital trade. For instance, payments allow consumers to purchase goods and services from online retailers and for companies to purchase from suppliers. The above-mentioned \$105 billion in cross-border online shopping in 2013 was largely enabled by electronic payments (PayPal 2013).

To complete an online transaction requires international payment options. One way is to pay using a credit card. Another is to use intermediary payment systems such as PayPal or VeriSign that facilitate payments among non-merchants who cannot accept conventional credit card payments (Mann 2003).

Credit cards and e-wallet services such as PayPal, Apple Pay and VeriSign offer convenient, cost-effective ways of paying for online transactions. Other innovative payment mechanisms are also being developed, such as Square—which facilitates electronic payment via mobiles for SMEs. Saficom uses tools such as M-Pesa that allows mobile phone users in Africa to make payments. Unlike bank transfers or cash, consumers and businesses can achieve more efficient delivery, less leakage, and greater security due the ability to stop payment in the case of fraud or non-receipt of the goods or services. For vendors, the ability to receive payment almost immediately can expedite the delivery process and help manage cash flows. Safe and reliable digital payment mechanisms are also important for building trust in using the Internet for international trade.

There are, however, limits on the ability of consumers to use international payments mechanisms (Mangiaracina 2009, 12). For instance, access to a bank account and credit card are generally minimal requirements, but in many developing countries such access is limited (Mann et al. 2000, 63). According to the World Bank (2014) up to 2.5 billion people do not have access to banks or credit cards.

Another important challenge is that regulation designed for traditional financial institutions also tend to apply to international payment systems. This often creates costs without providing corresponding social benefits. There are various other challenges to developing international payments systems. These include:

- A lack of clarity regarding regulatory approaches to traditional financial services versus digital services, and on regulatory structures that can be improved to enable innovative digital financial services which benefit both consumers and businesses, while at the same time permitting jurisdictions to address legitimate security and other threats;

- Government mandated ceilings on the maximum amount that can be purchased online;
- Difficulty in verifying who is making the transaction to avoid being complicit in illegal activities such as fraud, money laundering, or terrorist financing;
- Interchange rules that require local switching, limiting access to some of the more efficient firms and cross-border players;
- Constraints on foreign firms in providing support to transactions within countries; and
- Currency caps that limit the value of cross-border purchases.

#### 2.5.2. Restrictions on Internet openness

##### 2.5.2.1. Data localization requirements

At least 20 countries have considered or adopted measures that would require data localization of some kind, such as obliging a company to build data centres in country to serve that market (Chander and Le 2014). For example, Russia has proposed a law that would require Internet companies to locate servers in Russia and store user data for six months after the data was created. India has also proposed requiring all email service providers to host servers in India (Ibid).

As noted above, the Snowden leaks have been one reason that governments and businesses are formulating approaches to localizing data. Data localization requirements often are enacted for other reasons, including as an IT job creation strategy; to improve access to data by law enforcement; or to protect privacy (Hill 2014). In certain authoritarian nations, data localization is also likely driven by a desire for greater control over the information that is accessible to their population (Ibid).

Such requirements are of concern due to their impact on the costs of providing Internet-based services such as cloud computing. These restrictions reduce the global Internet's economies of scale, raising the costs of access to Internet-related services. In some cases, data localization requirements could lead the providers of data services to exit the market, leaving domestic business with access to less efficient and effective services. If implemented on a sufficiently global level, data localization raises the prospect of fragmenting the Internet from a global system into regional or country-based systems (Ibid).

Data localization policies are also unlikely to achieve many of their goals. For instance, data security is ultimately about having robust security procedures and storing data at multiple places to minimize the security costs of a data breach. As a result, data stored locally in one or only a few servers may well end up being less secure. As some experts have observed, data localization requirements “do nothing on their own to make data safer; in fact, they will only make it impossible for cloud service providers to take advantage of the Internet's distributed infrastructure and use sharding and obfuscation on a global scale” (Ryan et al. 2013).

Further, forcing companies to build data centres is going to produce only limited jobs and will likely result in net economic costs. This is because few people staff data centres once construction of the centre is finished. Yet data localization raises the costs of Internet services such as cloud computing, which negatively affects all economic sectors.

Where data localization is focused on developing a local cloud industry, this is also likely to raise costs of cloud services where the domestic cloud provider is not as efficient as the international option. Moreover, such a policy fails to recognize the general-purpose nature of the Internet and cloud computing and its aggregate significance for economic growth (Jovanovic and Rousseau 2005) For such technologies, broad-based and low cost access that maximizes its utilization should be the aim of government policy.

#### 2.5.2.2. Commercial restrictions

Restrictions on Internet content are also being used for commercial reasons. Such restrictions reduce the ability of buyers and sellers to transact and companies to operate across borders. In many cases, these restrictions are driven by the very success of foreign Internet-based companies, as governments seek to replicate their successes by adopting a digital version of infant industry industrial policy by protecting domestic Internet enterprises from foreign competition. These commercial Internet restrictions include routing traffic to domestically owned companies, blocking particular sites, or sufficiently degrading Internet access so that users turn to alternative and usually domestic websites.

These Internet restrictions are also frequently vague, not easily understood, and are administered in an arbitrary and non-transparent manner. For instance, the foreign company may not be aware that access to its website has been blocked.<sup>4</sup> Foreign ISPs also are usually unaware of the criteria used by governments to determine whether to block a website. This creates risk that particular websites or Internet servers that are available one day may not be available the next, making it difficult to run an online business as sporadic or slow access to a site deters consumers. These restrictions negatively affect sales, advertising revenues, and the scope and size of international trade.

#### 2.5.3. Regulatory externalities arising from digital trade

As outlined above, where the Internet enables the online delivery of services, domestic regulation can become an increasingly significant barrier. The Internet also enables people from one country to circumvent domestic regulatory regimes by consuming the service online, potentially undermining or making more difficult the achievement of regulatory goals in areas such as human health and safety. This is not a new phenomenon in that people have been able to travel to receive medical services. However, selling health services over the Internet avoids the cost of travel and can be done at scale. This creates policy externalities if, for instance, lower health regulation in an exporting country reduces the health of citizens consuming the online service, or less stringent privacy laws in one country undermine the stricter privacy laws in a third country (Mattoo 2015).

The response is not necessarily more regulation. Also, there may be benefits from regulatory diversity and the opportunities that the Internet provides to access such online services. For example, the Internet is enabling the provision of medical services to remote communities. The better approach here is to incentivize regulatory cooperation across countries to manage the various impacts of digital trade on domestic regulatory goals.

<sup>4</sup> See US request to China for information under paragraph 4 of Article III of the WTO General Agreement on Trade in Services.

# 3. Policy Options to Maximize Trade in the Digital Economy

The world is still in the early phase of developing and exploiting the commercial and other consequences of the Internet. Further establishing and maintaining a rules-based international trading system supportive of the digital economy is crucial to safeguard and enhance the benefits that flow to both developed and developing countries from the Internet itself and the digital economy. This requires both short and longer-term measures, actions by governments, firms, and private individuals, and continued examination of the existing rules frameworks within countries and at the international level. It also requires some new thinking and understanding about this dynamic area of economic change. What follows, therefore, are recommendations that include actions for the WTO, for policy-makers undertaking sectoral or regional initiatives, domestic regulators, private firms, expert groups and others.

As the discussion above has highlighted, an area of increasing importance is the treatment of data itself—within and between borders. Domestic regulatory frameworks are in flux in many countries and thus international frameworks are particularly hard to develop. New concerns are arising with respect to security and privacy, even as new opportunities arise for businesses and consumers alike.

A coherent and effective response to the challenges and opportunities presented by the Internet and data flows for trade will require heterodox and innovative approaches that involve all stakeholders. Trade policy and trade rules have an important role to play in clarifying existing commitments and developing new rules where opportunities arise, including in FTAs and at the WTO. The impact of digital trade on regulatory agendas means that cooperation at the regulatory level must also be part of the picture. This will require regulators to address difficult questions, such as how to assess the effectiveness of different privacy regimes and to develop mechanisms that allow such differences to co-exist without impeding cross-border data flows.

The private sector can also play an important role given the broad-based economic importance of the Internet and cross-border data flows for all sectors. As a result, companies are already experimenting with solutions, such as the need for a digital dispute settlement mechanism, frameworks to increase trust in digital trade, and responses to the need for online payment systems. Moreover, the dynamism of Internet use in the commercial space means that the private sector is often best placed to help governments and regulators understand the needs and impacts of proposed new rules.

The following identifies policy options that seem implementable, even if over the long term, given the complex range of political economy and institutional challenges.

## 3.1. Maximize and Update WTO Rules Both in the Near and Long Term

**Policy Option 1:** Implement and consider expanding the WTO Trade Facilitation Agreement to support digital trade (short to long term)

The recent WTO Trade Facilitation Agreement (TFA) is an important outcome on customs reform. The Agreement applies to all WTO members, although there is scope for developing and least developed country members to delay implementation of parts of the agreement.<sup>5</sup> The TFA will come into force only after two-thirds of WTO members ratify the agreement and this should be a priority goal.

The TFA supports digital trade in a number of important ways. For instance, it includes commitments to enhance transparency and accountability of customs procedures and officials; it requires the publication of all laws, regulations, procedures, and issues affecting trade; and much of this information must be made available on the Internet. WTO members have also agreed to establish inquiry points and to give traders, and other interested parties, opportunities for comment on proposed changes affecting customs procedures.

The agreement should also increase the speed with which goods move through customs by requiring WTO members to have procedures that allow submission of import documentation prior to arrival with the aim of expediting release of goods upon arrival. Members also have agreed to develop procedures for expedited release of goods through air cargo facilities. More explicit consideration of those dimensions of customs review and clearance that can be facilitated through digitization should be actively considered. This should include particular attention on the connectivity dimensions of these steps, such as requiring acceptance of digital submission of customs forms.

The TFA also fails to address the *de minimis* level of customs duties. Currently, countries apply different *de minimis* levels, ranging from \$1,000 to under \$1. The higher the *de minimis* level the higher the value of the good before duties are charged.

<sup>5</sup> WTO Agreement on Trade Facilitation, WT/MIN(13)/W/8, Section II.

Requiring businesses to make customs declarations for goods of low value creates additional transaction costs (Lesser and Moisé-Leeman 2009, 39). According to one study, a 10% increase in time to move goods across borders reduces exports of time-sensitive manufacturing goods by more than 4% (Djankov et al. 2010). For trade in lower value goods that the Internet is enabling, such costs account for a relatively larger share of the total value, making it an even more serious trade barrier. Moreover, it is the consumer that is responsible for completing customs forms and paying the duties, adding another barrier to digital trade. Returning goods are also often treated as imports, which means that they are again subject to similar documentation requirements and customs duties.

**Policy Option 2:** Make permanent the moratorium on customs duties on electronic transmissions (short term)

Currently, WTO members have agreed a moratorium on imposing customs duties on electronic transmission of products. It is expected that a further extension of this moratorium will be agreed during the WTO Nairobi Ministerial. However, a permanent moratorium should be the aim, as it would increase business certainty and further support digital trade.

**Policy Option 3:** Task the WTO to initiate an ambitious E-Commerce Work Programme that supports the digital economy and trade in both developing and developed economies, and expand WTO tools for gathering and disseminating data on digital trade (short term)

At the 2013 WTO Bali Ministerial, members instructed the General Council to substantially invigorate the Work Programme on Electronic Commerce. The WTO bodies responsible for this work programme—the Goods, Services, and TRIPS (intellectual property) Councils, and the Trade and Development Committee—have met a number of times since, but little progress appears to have been made.<sup>6</sup> WTO members should reaffirm the importance of this work and provide more specific direction on what this work programme should address. The WTO should consider establishing an external group of experts to recommend steps that could be taken to support digital trade. This could include establishing a platform in the WTO that would act as a repository of information and insight about the digital economy and its relationship to the international trade system, rules, and agreements. To this end, the WTO can enhance analytical work, assemble relevant information on regional and plurilateral agreements by identifying those portions that specifically address the digital economy, and convene expert and other groups to focus on this evolving area of global commerce.

#### Box 4: Existing Digital Trade Rules in US Trade Agreements

Some digital trade rules exist in the WTO and these have been expanded on in various FTAs that the US has been a party to. The recent US-Korea (KORUS) FTA provides the most up to date set of digital trade rules that are in force. Key KORUS digital trade rules are as follows:

- To allow financial institutions to transfer information across borders for data processing where such processing is required in the ordinary course of business;
- To “endeavor to refrain from imposing or maintaining unnecessary barriers to electronic information flows across borders.” This commitment is subject to the GATS Article XIV exceptions, which includes measures necessary for protection of privacy of individuals (KORUS FTA Article 23.1.2);
- Not to impose customs fees on trade in digital products;
- Not to discriminate in favour of domestic digital products over like imported digital products;
- Rules to encourage use of digital signatures;
- To promote cooperation among national consumer protection authorities on the prevention of deceptive practices in electronic commerce;
- Commitment to a set of digital trade principles; and
- Internet intermediary liability protection.

The TPP expands on KORUS digital trade rules and includes commitments on the free flow of data across borders subject to exceptions as well as disciplines on data localization requirements.

**Policy Option 4:** WTO bodies such as the Trade Policy Review Mechanism (TPRM), or an outside group of experts, should be tasked with evaluating the extent to which members’ digital trade-related measures are consistent with their existing WTO commitments, and report on digital protectionism measures around the world on an annual basis (medium term)

WTO rules in a number of areas already provide a strong foundation in support of the digital economy and digital trade (Enders and Porges 2015). Several cases that have gone through dispute settlement have addressed selective digital trade issues. Looking ahead, rather than move forward on a case-by-case basis, a WTO working group could be established to consider how the needs of digital trade are covered under the existing rules framework,

<sup>6</sup> WTO, “Item 6 – Work Programme on Electronic Commerce – Review of Progress, Report by Ambassador Alfredo Suescum – Friend of the Chair”, WT/GC/W/701, 24 July 2015.

identifying those areas where coverage is robust and those where it is either inadequate or ambiguous. Certain principles are already apparent:

- A GATS commitment already includes the electronic delivery of the service, even if electronic delivery of that service was not possible when the commitment was made (*US-Gambling; China-Audiovisual*);
- A GATS scheduled commitment on “all” of any service includes those services needed to deliver that service, including access to the Internet and the ability to transfer data across borders (*China-Electronic Payment*) (Enders and Porges 2015); and
- The WTO Telecommunications Annex commitment to access and use of public telecommunications transport networks for the delivery of a service includes those networks for online delivery (*China-Electronic Delivery*).

The working group (or external expert group) should also consider the principles and rules that have been developed in bilateral and regional fora that support digital trade. In addition, the TPRM (or group of experts) should be tasked with investigating whether WTO members have adopted measures that affect digital trade and might be inconsistent with their WTO commitments.

**Policy Option 5:** Conclude the expansion of the WTO Information Technology Agreement (ITA) (short term) and then increase its signatories (medium term)

The ITA—a plurilateral agreement involving 75 WTO members representing 97% of world trade in ICT products—has reduced tariffs to zero on a range of ICT goods. Growth in ITA exports has been at around 10% since the ITA was reached, faster than for other manufactured goods. Additionally, developing countries now represent over 40% of the ITA membership and account for over one third of global exports of ITA goods.

The ITA was finalized in 1997 and needs to be updated to include ICT goods developed over the last 15 year. However, progress in agreeing on an expanded list of goods has been slow. There is a large range of goods being proposed for inclusion in a new ITA that would reduce costs of developing Internet access. These include coded key cards used to access Internet content such as software; machines for making optical fibre for cables that provide Internet access; and machines used to make semiconductors that can drive down the costs of computers and mobile devices used to access the Internet (USITC 2012).

On 24 July 2015, an expanded list of tariff lines was agreed that would be subject to duty elimination. Countries should rapidly conclude implementation of the ITA expansion, including tariff schedules and staging. Expanded geographical coverage (India, Brazil, Mexico, and South Africa are not parties to the expansion agreed in 2015) should be a priority.

**Policy Option 6:** Consider updating the WTO Telecoms Reference Paper to ensure competition over the Internet (long-term)

The WTO Telecoms Reference Paper outlines a number of fundamental principles that are designed to regulate competition. It has only been subject to review or engagement under the rules of the WTO in one decision.<sup>7</sup>

The WTO Telecoms Reference Paper includes pro-competitive regulatory principles for the telecommunications sector, which are designed to ensure that former monopoly operators do not use their market power—such as control of access to telecommunications infrastructure—to undermine competitive opportunities for new market entrants (Brockers and Larouche 2008, 331). For instance, the Reference Paper requires WTO members to prevent “major suppliers” from engaging in anti-competitive practices such as cross-subsidization. The Reference Paper also includes commitments to allow for interconnection with a major supplier on non-discriminatory terms, in a timely fashion, and with cost-orientated rates. It also requires WTO members to allocate scarce resources such as spectrum in an objective, timely, transparent, and non-discriminatory manner.

The Reference Paper has been an important tool underpinning the move towards greater competition in the telecommunications sector. However, the Reference Paper is not fully self-explanatory and, as noted, has been litigated in the WTO only once. WTO members should seek to clarify the application of the Reference Paper to ensure the preconditions for competition over the Internet as well as traditional networks and update where necessary.

**Policy Option 7:** Clarify the application of WTO members’ GATS commitments to digital trade (medium term)

The convergence among basic and value-added telecommunications services has rendered the scope of GATS commitments increasingly unclear. According to the WTO, basic telecommunications services include, in addition to voice, the transmission of video but not the provision of email. GATS commitments have been made for basic telecommunications services. For example, almost all WTO members have made separate GATS commitments for telecommunications services and audiovisual services, yet as the Internet allows for video to be provided over telecommunications networks, it is unclear whether the supply of video over telecommunication lines is covered in GATS commitments (Luff 2012, 67). Clarity here would help determine the extent that GATS liberalizes relevant sectors for digital trade and where further market access is needed.

<sup>7</sup> WTO Panel Report, Mexico-Measures Affecting Telecommunications Services, WT/DS204/R. 2 April 2004.

## 3.2. Negotiate a Digital Trade Agreement

**Policy Option 8:** Negotiate digital trade rules in the Transatlantic Trade and Investment Partnership (TTIP), the Trade in Services Agreement (TiSA), and conclude a plurilateral digital trade agreement at the WTO (medium term)

In our view, critical areas of examination over the medium term are the evolving national and international frameworks that impact cross-border data flows. Data has become central to innovation by companies big and small, and essential to global value chains. As discussed, regulation around data can be a disguised restriction on trade with unintended consequences for employment, growth, and innovation. There is a need to develop greater consensus or a critical mass around core concepts regarding cross-border data flows. Rules and principles to support and expand digital trade are being inserted in some trade agreements. This is a positive step that should be discussed and expanded to more jurisdictions.

As indicated, the TPP Agreement includes new rules on digital trade. The US and EU, in TTIP, and the countries negotiating TiSA, should build on these rules. In addition, digital trade principles have been agreed in the OECD and bilaterally, such as the US-Japan Internet principles. This work provides a basis for developing a specific agreement on digital trade that should be negotiated at the WTO on a plurilateral basis—open to those interested in joining, with consideration given to applying any such agreement on an MFN basis to all WTO members.

In addition to considering the inclusion of the above options in a trade agreement, the following are further key commitments that should be part of any set of digital trade rules.

**Policy Option 9:** Expand services market access commitments that implicate cross-border data flows (medium term)

The potential for the Internet to grow services trade makes addressing services trade barriers particularly important.

Reducing barriers to services is part of the WTO Doha Round but progress remains slow. In the meantime, services liberalization is being pursued in FTAs, the most important being TiSA, the TPP, and the TTIP. These negotiations should be the immediate focus for expanding market access commitments for services trade.

**Policy Option 10:** Allow for the free flow of data across borders subject to an exceptions provision based on GATS Article XIV and a tightly-constrained national security exception (medium term)

Currently there are only limited commitments specific to cross-border data flows, although restrictions on such flows may implicate a variety of WTO commitments. The WTO Understanding on Commitments in Financial Services includes agreement that members will not “prevent transfers of information or the processing of financial information,

including transfers of data by electronic means.” This commitment, however, is balanced against the right of a WTO member to protect personal data and personal privacy so long as such right is not used to circumvent the provisions of this agreement.

In KORUS, the US and Korea upgraded their commitment and agreed to allow financial institutions to transfer information across borders for data processing where such processing is required in the ordinary course of business. Unlike the WTO commitment, KORUS (Annex13-B, Section B) does not balance this right to transfer data with the right of a party to protect personal data.

These commitments, however, are limited to the financial sector and need to be expanded. KORUS (Article 15.8) has taken a step in this direction and includes a commitment by the parties to “endeavor to refrain from imposing or maintaining unnecessary barriers to electronic information flows across borders” (see Box 4). This commitment is appropriately subject to the GATS Article XIV exceptions, which include measures necessary for protecting the privacy of individuals, as well as a national security exception. However, the hortatory nature of this commitment limits its effectiveness. More binding disciplines may be necessary to facilitate the flow of data.

Furthermore, many WTO members have made GATS commitments on cross-border computer and related services. Restrictions on cross-border data flows could violate these existing commitments, as well as provisions on access to information included in the Basic Telecom Agreement.

**Policy Option 11:** Commit to not require data localization (medium term)

Trade agreements should include commitments to not require data to be stored locally. The TPP agreement will be the first to include disciplines in this area once it has been ratified. At the same time, governments, the private sector, and NGOs should work to address the concerns and goals that motivate data localization laws. This includes:

- Reform of the mutual legal assistance treaties (MLATs): MLATs provide a framework for a law enforcement agency to request information being stored in another jurisdiction. However, the MLAT process is often circumvented due to its often slow and cumbersome procedures (such as in the current *Microsoft-Ireland* case). Governments should seek to improve the use of MLATs in parallel with rules preventing data localization laws.
- Commitments with regards data encryption would give consumers greater confidence that their data will not be accessed without a valid subpoena (Hill 2014).
- Cooperation on data privacy regulation (see below).

**Policy Option 12:** Include a balanced set of IP rules and intermediary liability protections—including enforcement measures, limitations and exceptions such as fair use, and appropriate protections from IP and non-IP intermediary liability (medium term)

As discussed, the Internet enables diverse new forms of digital content to be traded across borders, as well as the creation of new business models based on user-generated content and communications. A balanced IP regime with effective enforcement measures, clear limitations and exceptions such as fair use, and appropriate protections from intermediary liability will help promote these new forms of digital trade. The TPP for instance requires parties to “achieve an appropriate balance” in their copyright systems through limitations and exceptions (such as fair use).

The liability of Internet intermediaries such as ISPs and Internet platforms for international trade is an area that has yet to be addressed in the WTO. The challenge is to balance the need to protect IP rights while enabling Internet services to grow as platforms for online creativity, innovation, and expression.<sup>8</sup>

Some rules in this area are already being developed in FTAs and regional agreements. For example, TPP requires parties to establish a system of copyright safe harbours for Internet services, and prohibits parties from making these safe harbours contingent on ISPs monitoring their systems for infringing activity. Similar rules that require a balanced set of IP rules as well as providing safe harbour could be included in other trade agreements such as the TTIP and TiSA.

### 3.3. Expand and Deepen Regulatory Cooperation on Digital Trade Issues

**Policy Option 13:** Develop regulatory cooperation in areas affected by digital trade (medium term)

There are a number of areas where regulatory cooperation could address barriers to digital trade. The following is an outline of some of the main ones.

*Privacy:* Privacy of personal data online is an important and growing issue that underpins trust in digital trade. There is no global approach or level of privacy. However, and as outlined above, lower levels of privacy protection in one country can have consequences in trade and economic relations between nations.

Such an issue has arisen in the context of US-EU data flows where the EU view that the US did not provide an “adequate” level of privacy protection in the US would have meant that under the EU Privacy Directive, personal data collected from the EU could not be transferred to the US—a costly restriction on a trade relationship valued at over \$650 billion annually.<sup>9</sup>

The solution was regulatory cooperation in the form of the US-EU safe harbour framework. The safe harbour framework consists of seven principles that largely reflect the key elements of the EU Data Protection Directive. Under the framework, US organizations can either join a self-regulatory privacy programme that adheres to the safe harbour principles or self-certify (the most common approach) to the Department of Commerce that they are complying with these principles. Additionally, the US companies must identify in their publically available privacy policy that they adhere to and comply with the safe harbour principles.

However, the recent European Court of Justice (ECJ) decision mentioned above calls into question the effectiveness of the EU-US Safe Harbour agreement for enabling the transfer of personal EU data to the US.<sup>10</sup> In doing so, this ECJ decision underscores the need for transnational regulatory cooperation that supports cross-border data flows and the achievement of other regulatory goals such as the privacy of personal information.

*Consumer Protection:* Cooperation among consumer protection agencies can help increase consumer protection for digital trade and thus raise confidence and willingness to engage in such trade. This is also a regulatory agenda for which commitments could be included in trade agreements. For instance, KORUS (Article 15.5 and 16.6) requires that consumer protection agencies in Korea and the US cooperate in the enforcement of each other’s laws against fraudulent and deceptive practices. Broadening such commitments among countries is one way to give impetus to further cooperation among agencies.

*Rules on online contract enforcement and formation:* This is an area amenable to international rule-making and cooperation among national agencies. In its FTA e-commerce chapters the US includes commitments that go some way towards addressing the absence of common rules on contract formation online. For example, in KORUS (Article 15.4.1(a)) the parties to the FTA agree not to prevent the parties to an electronic transaction from determining their own authentication methods. Additionally, KORUS (Article 15.4.2) requires the authentication of e-commerce transactions to meet certain performance standards where these standards are necessary to achieve a legitimate government objective. Other regulatory approaches are also possible. For instance, countries could seek to agree on ways to mutually recognize their laws on electronic signature and authentication methods.

<sup>8</sup> As mentioned supra, in the US, this balance is reflected in the 1998 Digital Millennium Copyright Act, which creates a safe harbour for ISPs that are unaware of hosting IP infringing content and requires its removal upon receipt of a takedown notice. The OECD has also examined the challenges of promoting effective IP enforcement and establishing appropriate limits on the liability of intermediaries.

<sup>9</sup> Working Party on the Protection of Individuals with Regard to the Processing of Personal Data, Opinion 1/99 Concerning the Level of Data Protection in the United States and the Ongoing Discussion Between the European Commission and the United States Government, at 4, DG MARKT Doc. 5092/98/WP 15 (Jan, 26, 1999).

<sup>10</sup> Maximilian Schrems v. Data Protection Authority (op. cit.).

*Transparency and due process:* This is less a matter of cooperation among regulators than a set of reforms that regulators can undertake domestically. The main reforms would require regulators to consider the digital trade effects of regulation. This could include opportunities for stakeholders from exporting countries to learn of the regulation before it comes into effect and to have an opportunity to provide comments. This would give regulators information about the specific trade impacts of regulations and provide space for their consideration before the regulation is finalized. Requirements for responses to such comments would make it more difficult to justify regulations adopted for protectionist reasons.

**Policy Option 14:** Improve the regulation of digital payment services (medium term)

As discussed in section 2.5.1.5, realizing the benefits of digital trade calls for international payment systems that enable consumers to purchase goods and services online. A number of elements need to be addressed, including the following:

- New services commitments in trade agreements should remove restrictions of financial flows across borders;
- Regulation tailored for international payment providers that enables innovation consistent with the systemic risk from such entities;
- Commitment to the free flow of data which allows banks and credit card companies to verify and authorize payments;
- Access to global information allows financial institutions to develop better risk profile that more accurately reflect the risk of lending to a particular business—the current absence of risk profiles for many developing country businesses leads to higher costs of capital; and
- Countries should make transparent and easily accessible their requirements on banks and non-financial institutions for reporting suspected illegal activities such as money laundering and terrorist financing.

**Policy Option 15:** Develop a dispute settlement mechanism for digital trade (medium term)

As discussed, a dispute settlement process is needed that can respond in a timely and cost-effective way to issues that arise in the context of digital trade.

There are already some efforts to develop dispute settlement mechanisms for digital trade and these should be expanded on. For instance, the 2007 OECD Recommendations on Consumer Dispute Resolution and Redress look at the need to provide consumers with access to dispute resolution for cross-border disputes. The OECD recommendations emphasize the need for states to encourage businesses to establish voluntary, effective, and timely mechanisms for handling and settling complaints from consumers, including “private third party alternative dispute resolution services, by which businesses establish, finance, or run out-of-court consensual processes or adjudicative processes to resolve disputes between that business and consumers.”

Additionally, the United Nations Commission on International Trade Law (UNCITRAL) has established a working group to develop model rules on alternative dispute resolution processes, which “are intended for use in the context of cross-border, low value, high volume transactions conducted by means of electronic communication.”

As outlined above, eBay has developed a dispute settlement mechanism for disputes arising on its platform. A dispute settlement mechanism that builds on such experience and which is quick, cost-effective, globally available, and enforceable seems to be the key elements. In the following section there is a recommendation regarding a role for the private sector in further developing and expanding such a dispute settlement mechanism. Indeed, this is an area where public-private sector cooperation is needed to develop an approach that is effective and responds to the needs of digital traders globally.

### **3.4. Governments, Businesses, and NGOs Working Together to Support Digital Trade**

**Policy Option 16:** Improve data gathering and metrics concerning digital trade (medium term)

The absence of quantitative data on the extent of digital trade and importance of the Internet and data flows for economic growth and jobs remains an important limit on understanding the scale of the issue and what it means from a policy perspective. Government statistics agencies need to take the lead in collecting data on the digital economy and digital trade. International organizations such as the OECD and the World Bank could also play a role.

At the same time, business can also be more active in this space as the private sector often has access to aggregate data that can help shed light on the economic impact of digital trade and data flows.

**Policy Option 17:** Enhance government and private sector cooperation on digital trade issues (medium term)

Many of the above recommendations for new trade rules would be enhanced with parallel work and engagement by the private sectors and NGOs. Private sector initiatives in developing dispute settlement mechanisms for digital trade, for example, are outlined in policy option 15.

Another area ripe for engagement and work by the private sector is on data security. Ensuring security of the network is one of the key issues that effects consumer and business confidence in digital trade, in addition to the direct costs that security breaches have on individual businesses. The Obama Administration is already working with the business community to identify the scope of the issue and potential responses, including the importance of encryption. Indeed, the administration has included encryption as one of their core digital trade goals as a means of addressing security and privacy concerns (USTR 2015).

The private sector could also take a lead role in building on and expanding acceptance of digital trade principles on the importance of the Internet and data flows for trade and investment. For example, the US-Japan Internet Economy Industry Working Group has developed policy proposals for government on how to ensure the openness of the Internet (Keidanren 2014). Yet the significance of this issue remains poorly understood globally. It is often still seen as a priority for the IT sector alone; and the broad-based importance of the Internet for all economic sectors is underappreciated. It is thus necessary to build greater awareness and develop consensus around principles that recognize the value of the digital economy and trade and that can guide government regulation of the Internet. This could involve private sector input in economic fora such as APEC and the OECD, where such principles have been developed and could be expanded. It could also include purely private sector led outcomes using the World Economic Forum or other business groups.

**Policy Option 18:** Expand financing of digital infrastructure in developing countries (medium-long term)

Governments, the private sector, and NGOs should build on the importance assigned to Internet access in the SDGs. This could include developing innovative financing models to expand broadband infrastructure and to reduce the cost of access to Internet-enabled devices in developing countries. Official development assistance and financing from international financial institutions (including the newly established Asian Infrastructure Investment Bank) is particularly relevant here as a way of reducing the risk of such investments and using public balance sheets to crowd-in private sector finance.

As a corollary, the World Bank should consider updating its Ease of Doing Business methodology to include in its Trading Across Borders section the ease of cross-border data flows.

# 4. Concluding Note

Data is increasingly central to how governments, businesses, and people conduct their affairs. The ability to move data across borders also underpins the globalization of the Internet, global supply chains, and foreign investment. Companies are using data to reach consumers, innovate, and develop new business models. Businesses and consumers in developing countries as well as SMEs are using access to the Internet to become part of the global economy in ways that were not previously possible. As a result, the Internet and global data flows are creating new opportunities for more inclusive growth and employment.

At the same time, governments are grappling with some of the challenges presented by the ability to rapidly and seamlessly move large quantities of data overseas. For instance, lower levels of privacy for personal data and consumer protection laws in one country can undermine these standards in the data exporting country. Such regulatory externalities from global data flows points to the need for increased regulatory cooperation. Some governments are also blocking access to online content to protect domestic businesses or due to political concerns.

Current international trade and investment rules and norms navigate between competing goals and do not adequately support an open Internet or the flow of data across borders. This report provides a broad range of recommendations for action by governments, businesses, and NGOs to engage in new forms of regulatory cooperation and the learning and sharing of experience. The objective is to develop a comprehensive set of international trade rules, norms, and frameworks that seek to ensure that the opportunities of the Internet and global data flows are fully realized.

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The papers commissioned for the E15 Expert Group on the Digital Economy can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>Maximize and Update WTO rules both in the near and long term</b>					
<b>1. Implement and consider expanding the WTO Trade Facilitation Agreement (TFA) to support digital trade</b>	Short-Long term	TFA will enter into force when two thirds of WTO membership will ratify it	TFA does not sufficiently take into account digitization and the specific characteristics of digital trade It fails to address the de minimis level of customs duties	Measures could be introduced in TFA to: <ul style="list-style-type: none"> <li>– Require acceptance by customs of digital submission of customs forms</li> <li>– Reduce transaction costs for goods of small value</li> </ul>	WTO members
<b>2. Make permanent the moratorium on customs duties on electronic transmissions.</b>	Short Term	The WTO moratorium on imposing customs duties on electronic transmission of products has been renewed six times at WTO Ministerial Conferences	The moratorium has never been made permanent and legally binding	The moratorium should be made permanent as such a move would increase certainty amongst businesses and further support digital trade	WTO members
<b>3. Task the WTO to set forth an ambitious E-Commerce Work Programme</b>	Short Term	At the 2013 WTO Bali Ministerial, Members instructed the General Council to substantially invigorate the E-Commerce Work Programme  The Nairobi Ministerial in December 2015 reaffirmed this programme	Little progress has been made in substantive discussions in this area	<ul style="list-style-type: none"> <li>– Provide more specific direction on what the E-Commerce Work Programme should address</li> <li>– The WTO should consider establishing an external group of experts to recommend steps that could be taken to support digital trade</li> <li>– This could include establishing the WTO as a repository of information and insight about the digital economy and its relationship to the international trading system and agreements</li> </ul>	WTO members

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
4. <b>WTO bodies such as the Trade Policy Review Mechanism or an outside group of experts should be tasked with evaluating the extent to which Members' digital-trade-related measures are consistent with their existing WTO commitments</b>	Medium Term	WTO rules in a number of areas provide a strong foundation in support of the digital economy and digital trade	There are a number of areas where the coverage by WTO rules of the digital trade needs might be ambiguous or inadequate	A WTO working group or body could consider <ul style="list-style-type: none"> <li>– How the needs of digital trade are covered under the WTO existing rule framework</li> <li>– Report on current digital protectionism measures around the world on an annual basis</li> <li>– Evaluate the extent to which members' digital-trade-related measures are consistent with their existing WTO commitments</li> </ul>	WTO members
5. <b>Conclude expansion of the Information Technology Agreement (ITA) and increase its signatories</b>	Short-Medium Term	The ITA is a plurilateral agreement involving 75 WTO members representing 97 percent of world trade in ICT products. It has reduced tariffs to zero on a range of ICT goods	The ITA needs to be updated to include IT goods developed over the last 15 year. However, progress agreeing on an expanded list of goods has been slow. Finally, on 24 July 2015, an expanded list of tariff lines was agreed that would be subject to duty elimination	<ul style="list-style-type: none"> <li>– Countries should build on the conclusion of ITA-II agreed at the WTO ministerial in Nairobi</li> <li>– Expansion of the number of countries in ITA (India, Brazil, Mexico and South Africa are not members of this new expansion) should be a priority post-Nairobi.</li> </ul>	WTO members
6. <b>Consider updating the WTO Telecoms Reference Paper to ensure competition over the Internet</b>	Long Term	The WTO Telecoms Reference paper outlines a number of principles that are designed to regulate competition in telecommunications	The Reference Paper is not fully self-explanatory and has been litigated and used in the WTO context infrequently	WTO members should seek to clarify the application of the Reference Paper to ensure the preconditions for competition over the Internet as well as traditional networks and update where necessary	WTO members
7. <b>Clarify the application of WTO members' GATS commitments to digital trade</b>	Medium Term	The GATS commitments were originally made for basic telecommunications services	The convergence amongst basic and value added telecommunication services have rendered the scope of GATS commitments increasingly unclear	WTO members should clarify the extent that GATS liberalizes relevant sectors for digital trade and where further market access is needed	WTO members
<b>Negotiate a Digital Trade Agreement</b>					
8. <b>Negotiate digital trade rules in TTIP, TiSA and conclude a plurilateral digital trade agreement at the WTO</b>	Medium Term	Regulation around data can be a disguised restriction on trade	There is a need to develop greater consensus or a critical mass around core concepts regarding cross-border data flows	<ul style="list-style-type: none"> <li>– The US and the EU in TTIP and the countries negotiating TiSA should build on new rules for digital trade such as those in TPP</li> <li>– Develop a specific agreement on digital trade to be negotiated at the WTO on a plurilateral basis, with consideration given to applying any such agreement on an MFN basis to all WTO members</li> </ul>	TTIP parties TiSA parties WTO members

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>9. Expand services market access commitments that implicate cross border data flows</b>	Medium Term	The potential for the Internet to grow services trade makes addressing services trade barriers important	Reducing barriers to services is part of the WTO Doha Round but progress remains slow	TiSA, the TPP and the TTIP negotiations should be the immediate focus for expanding market access commitments for services trade	TTIP parties TiSA parties
<b>10. Allow for the free flow of data across borders subject to an exceptions provision based on GATS Article XIV and a tightly-constrained national security exception</b>	Medium Term	Currently there are only limited commitments specific to cross-border data flows, though restrictions on cross-border data flows may implicate a variety of WTO commitments	There is need for firm commitments to allow cross border data flows	More binding commitments are needed to ensure the free flow of data across borders subject to an exceptions provision based on GATS Article XIV and a tightly-constrained national security exception	WTO members
<b>11. Commit to not require data localization</b>	Medium Term	Trade agreements do not currently include a binding rule to not require data localization	Regulation around data can be a disguised restriction on trade with unintended consequences for employment growth and innovation	<ul style="list-style-type: none"> <li>– Trade agreements should include firm commitments to not require data localisation</li> <li>– Governments, the private sector and NGOs should work to address the concerns and goals that motivate data localization laws</li> </ul>	TTIP parties TiSA parties
<b>12. Include a balanced set of intellectual property (IP) rules and intermediary liability protections -- including enforcement measures, limitations and exceptions such as fair use, and appropriate protections from IP and non-IP intermediary liability</b>	Medium Term	A balanced IP regime with effective enforcement measures, clear limitations and exceptions such as fair use, and appropriate protections from intermediary liability facilitates digital trade	The liability of Internet intermediaries such as ISPs and Internet platforms for international trade is an area that has yet to be addressed in the WTO. Some rules in this area are being developed in FTAs such as TPP	Include a balanced set of IP rules and intermediary liability protections in trade agreements	WTO members TTIP parties TiSA parties

Policy Options	Timescale	Current Status	Gap	Steps	Parties
<b>Expand and deepen regulatory cooperation on digital trade issues</b>					
<b>13. Develop regulatory cooperation in areas affected by digital trade</b>	Medium Term	The lack of regulatory cooperation in areas such as privacy, consumer protection, and transparency can hinder digital trade	Lower levels of privacy protection in one country can have consequences in trade and economic relations between nations	There is a need to develop regulatory cooperation in areas affected by digital trade	WTO members TTIP parties TiSA parties
<b>14. Improve the regulation of digital payment services</b>	Medium Term	Maximising the benefits of digital trade requires international payments systems that allow consumers to purchase goods and services online	There are multiple barriers to access international payments mechanisms which are a crucial underpinning of all forms of digital trade	To address these barriers, countries should consider: <ul style="list-style-type: none"> <li>– New services commitments in trade agreements to remove restrictions of financial flows across borders</li> <li>– Developing regulations tailored for international payment providers that enables innovation consistent with the systemic risk from such entities compared with financial institutions</li> <li>– Commitment to the free flow of data so banks and credit card companies can verify and authorize payments</li> <li>– Countries should make transparent and easily accessible their requirements on banks and non-financial institutions for reporting suspected illegal activities such as money laundering and terrorist financing</li> </ul>	WTO members TTIP parties TiSA parties Private sector
<b>15. Develop a dispute settlement mechanism for digital trade</b>	Medium Term	The impact of the Internet on international trade raises new challenges for disputes settlement	There is currently no global dispute settlement mechanism capable of resolving digital trade disputes in a timely or cost-effective way	<ul style="list-style-type: none"> <li>– Develop a dispute settlement mechanism that is quick, cost effective and globally available and enforceable</li> <li>– Public-private sector cooperation is needed in this area to develop an approach that is effective, responds to the needs of digital traders and that can be enforced globally</li> </ul>	Governments Private Sector

Policy Options	Timescale	Current Status	Gap	Steps	Parties
<b>Governments, business, and NGOs working together to support digital trade</b>					
<b>16. Improve data gathering &amp; metrics concerning digital trade</b>	Medium Term	There is a need to Improve data gathering and metrics concerning digital trade	The lack of quantitative data on the extent of digital trade for economic growth and jobs remains an important limit on understanding the scale of the issue	<ul style="list-style-type: none"> <li>– Government statistics agencies and international organizations such as the OECD and the World Bank should take the lead in collecting data on the digital economy and digital trade.</li> <li>– Business can also play a more active as the private sector often has access to aggregate data that can help shed light on the economic impact of digital trade</li> </ul>	Governments OECD World Bank Private sector
<b>17. Enhance government/private sector cooperation on digital trade issues</b>	Medium Term	The private sector plays a leading role in digital trade	A global framework on digital trade should effectively address to the needs of the private sector and digital traders	<p>The private sector can play a leading role in:</p> <ul style="list-style-type: none"> <li>– Developing dispute settlement mechanisms for digital trade</li> <li>– Ensuring data security given its importance for consumer and business confidence in digital trade</li> <li>– Expanding acceptance globally of digital trade principles on the importance of the Internet and data flows for trade and investment</li> </ul>	Governments Private sector
<b>18. Expand financing of digital infrastructure in developing countries</b>	Medium-Long Term	The role of Internet access and ICTs as a development outcome is recognized in the draft post-2015 Sustainable Development Goals (SDGs). However, Many countries lack a robust digital infrastructure to be able to fully reap the benefits of digital trade	Accessing financial resources to build the digital infrastructure in developing countries remains challenging	<ul style="list-style-type: none"> <li>– There is a need for innovative financing models for building out broadband and reducing the cost of access to Internet-enabled devices in developing countries</li> <li>– The World Bank should consider updating its Ease of Doing Business methodology to include in its Trading across Borders part, the ease of cross-border data flows</li> <li>– Governments business and NGOs should build on the importance of Internet access in the SDGs</li> </ul>	Donor countries ODA agencies World Bank Regional development banks

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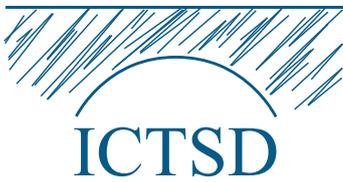
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# Options for Trade, Finance and Development: Getting the Institutions Right

Policy Options Paper



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# Options for Trade, Finance and Development: Getting the Institutions Right

Jean-Louis Arcand

on behalf of the E15 Expert Group on Trade, Finance and Development

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Trade, Finance and Development. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15 Initiative and authored by group members. Jean-Louis Arcand was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced below.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:

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# Abstract

The basic tenet of the present policy paper is that economic institutions are the key determinant of economic growth and development, and that policy-makers and developing country governments dealing with trade and finance must concentrate on “getting the institutions right.” In order to be implementable, policy recommendations must correct inefficiencies that the market system will not, implying that correcting market (and institutional) failures constitutes the crux of the policy options. These fall under four headings, informed by the standard list of canonical market failures. First, the widespread existence of externalities and coordination failure imply that: (i) strategic use should be made of official development assistance and blended finance; (ii) domestic resources in developing countries should be better mobilized through stronger domestic tax institutions and a more transparent international tax system; (iii) guidelines should be adopted for broadly-used private standards that affect trade; and (iv) duty-free and quota-free preferences, alongside liberal rules of origin with extended cumulation provisions, should be extended to all least developed countries. Second, standard public goods arguments imply a pressing need for: (i) development-led legal and regulatory reform; (ii) the implementation of a

long overdue trade facilitation framework for services; (iii) the realignment of incentives that determine the sectoral allocation of Aid for Trade funds towards the services sector; (iv) ensuring the availability of correspondent banks in all low-income countries which are otherwise largely cut off from the trading system; and (v) contributing to the construction of a global coordination mechanism for trade and supply chain finance. Third, natural monopoly arguments at the regional level call for: (i) enhanced mechanisms for regional regulatory cooperation in general and financial services in particular; and (ii) enhanced regional aid for trade. Fourth, the existence of asymmetric information problems faced both by developing country governments and international investors suggest a pressing need to: (i) improve technical advice on international economic agreements (including public-private partnerships) available to developing country governments; and (ii) adopt model solvency schemes and debt restructuring approaches. The paper concludes with a recommendation on measuring progress on these policy options through the construction of an aggregate index of “institutional readiness.”

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<b>Abbreviations</b>	
AfT	Aid for Trade
AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
BEPS	base-erosion and profit-shifting
BIS	Bank for International Settlements
CDS	credit default swap
CIT	corporate income tax
DFQF	duty-free and quota-free
DTIS	Diagnostic Trade Integration Study
EIF	Enhanced Integrated Framework
FSB	Financial Stability Board
G20	Group of Twenty major economies
GATS	General Agreement on Trade in Services
IFC	International Finance Corporation
IMF	International Monetary Fund
ITC	International Trade Centre
KYC	Know Your Customer
LDC	least developed country
MDGs	Millennium Development Goals
MNE	multinational enterprise
MSME	micro, small and medium enterprise
ODA	official development assistance
OECD	Organisation for Economic Co-Operation and Development
PPP	public-private partnership
SDGs	Sustainable Development Goals
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barrier to trade
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization
US	United States
WTO	World Trade Organization

# Executive Summary

The primacy of economic institutions as determinants of economic growth and development is a key empirical regularity that has emerged from the past two decades of research. The mechanisms through which trade and finance affect development do not escape this pattern. Broad agreement was reached among the members of the E15 Expert Group on Trade, Finance and Development, convened by ICTSD and the World Economic Forum in partnership with the Center for International Development at Harvard University, that strengthening the enabling environment through concrete policy proposals in the trade and finance arena is one of the most important ways of advancing the 2030 Agenda for Sustainable Development and the attendant Sustainable Development Goals (SDGs). Members of the Group were also keenly aware of the fact that, to be politically palatable, its proposals would have to pass the “market failure test.” Namely, any meaningful policy proposal would have to be justified on the basis of the underlying problem not being adequately dealt with by the private market system.

The Expert Group has surmounted this challenge and the outcome takes the form of the thirteen recommendations laid out in what follows. The policy options are grouped under headings that correspond to the four canonical forms taken by market failures: externalities, public goods, natural monopolies and asymmetric information.

## Policy Options

### *Externalities and coordination failure*

Externalities arise when the private cost or benefit of an activity is not equal to its social cost or benefit. Four recommendations fall under this category.

First, there is a need to focus official development assistance (ODA) in a manner that increases its marginal productivity, often through a focus on building institutions that strengthen the enabling environment, as well as by using it to leverage private sources of capital through blended finance. There is also the potential for improving the productivity of domestic financial resources. In basic economic terms, the social benefit of ODA is significantly higher than its private benefit, and current arrangements fail to “internalize” this potentially valuable positive externality, including ODA’s role in helping to ensure a stable macroeconomic environment. Second, tax policy is a key determinant of the behaviour of firms, be they domestic or

multinational. In order to increase the capacity for domestic resource mobilization of poor countries, major efforts—both at the international and domestic level—need to be made in terms of revamping policies aimed at combatting “base-erosion and profit-shifting” (BEPS). Third, there is a manifest issue of coordination failure involved when it comes to international standards set by dominant private firms, and which cannot be solved in existing fora such as the World Trade Organization (WTO). The adoption of standards is a typical example of a situation where coordination, in order to achieve a socially efficient outcome, is paramount: in the absence of outside involvement, coordination failure is likely. The gains to adopting well-crafted standards can also be characterized as a situation where there are significant positive network externalities to be internalized. Fourth, there has also been a manifest lack of coordination (and political will) in terms of duty-free and quota-free preferences when it comes to the least developed countries (LDCs). The United States, first and foremost, and large emerging powers should therefore accord such access where they have not, and include extended cumulation provisions in their rules of origin to maximize preference utilization by LDCs.

### *Public goods*

At the intra-country level, economic institutions—broadly understood to be legal, enabling and regulatory structures that facilitate wealth-enhancing exchange—are the key public good. Public goods and services possess two characteristics. First, they are non-exclusive: once they are provided, they are available to all irrespective of whether or not they were involved in their financing. Second, they are non-rival: the consumption of the good or service by a given agent does not reduce its consumption by others (if the good, service or institutional structure is rival, then we shift to the slightly different concept of a “common property resource”). As such, they are the best example of goods, services or institutional structures that will be underprovided by the market mechanism and where outside intervention is needed.

The Group formulated five policy options that fall under the public goods heading. All five proposals are typical examples of institutional public goods that would go a long way towards improving the enabling environment in low-income countries, allowing them to harness the development potential of international trade.

First, legal and regulatory reform has to be more development-led: without a well-functioning legal and regulatory framework, economic activity will not develop, but these structures have to be better adapted to developing country circumstances. While this is not a policy recommendation *per se*, it should be kept in mind when designing concrete legal and regulatory policy options. Second, given the pro-poor bias of the services sector, a trade facilitation framework for services is urgently required. Third, and related to the second recommendation, the incentives that determine the sectoral allocation of Aid for Trade funds, which currently tend to ignore the services sector, need to be modified. Fourth, heightened regulatory requirements have led to many low-income countries being functionally cut off from international financial markets by the simple lack of a correspondent (international) bank. Solving this problem in the short run, which is both feasible and relatively low cost, would make a significant contribution to facilitating international trade for firms located in low-income countries. Fifth, the E15 Initiative should contribute to efforts aimed at coordinating trade and supply chain finance.

### *Natural monopolies at the regional level*

Natural monopolies occur when it is socially efficient, from the cost standpoint, to have a single supplier for a given good or service. Of course, the productive efficiency argument immediately begs the question of how to regulate the ensuing monopolistic structure.

For the two policy options that fall under this heading, the Group has used the natural monopoly framework in a slightly less restrictive form. The main point is that there are a number of key institutional failures that are more efficiently dealt with at the regional, rather than national, level because of the importance of underlying economies of scale and scope. The two proposals involve strengthening regional mechanisms dealing with the regulatory aspects of cross-border financial services, foreign direct investment regimes, competition policy and standards, and enhancing, through the appropriate incentives, regional aid for trade initiatives.

### *Asymmetric information*

Asymmetric information arises when, in a bilateral relationship, one party knows something that the other does not. In the market failure framework, this can be interpreted as there being a missing market for the underlying information, which can lead to severe inefficiencies.

The two policy options proposed by the Group under the asymmetric information heading involve: first, strengthening the capacity of developing country government to negotiate and implement public-private partnerships as well as long-term contracts in crucial areas such as extractive industries; and, second, providing low-income countries with access to world class advice as well as in-country capacity building geared towards improving their position when it comes to designing and negotiating sovereign bond issuances and debt restructuring. In both of these fields, low-income countries are currently at a serious informational disadvantage vis-à-vis their international interlocutors.

## Next Steps

The policy options put forward by the Expert Group range from ambitious long-term recommendations to options that should technically (if not politically) be easy to implement in the short term. In all cases, work on these options should start immediately. The policy options are broken down into three categories over an indicative time horizon, depending on their ease of implementation (including financing constraints). The paper concludes with a recommendation on measuring progress through the construction of an aggregate index of “institutional readiness.”

# 1. Introduction

During the past twenty years, our understanding of the determinants of economic growth and development has been profoundly shaped by a vast corpus of cross-country empirical literature. Though it is something of an oversimplification, this literature has given rise to two broadly defined schools of thought concerning the key constraints to economic development and growth, with trade and finance playing a pivotal role.

On the one hand, the “geography” school, often associated with the name of Jeffrey Sachs, holds that a country’s development performance is to a large extent determined by its geographical location.<sup>1</sup> For example, it is argued that a country’s level of GDP per capita is, *ceteris paribus*, an increasing function of its distance to the equator; similarly, landlocked countries are believed to have both a lower level and a lower growth rate of GDP per capita. There are many causal pathways that can explain geographically driven income and growth effects, including the higher burden of disease under subtropical climates, or the infrastructure needed to overcome geographic isolation from world markets for landlocked countries. In a traditional growth accounting framework, both of these examples underscore the fact that geographical fetters to development affect total factor productivity, the overall efficiency with which factors of production such as labour and capital (both human and physical) are transformed into output, the productivity of single factors of production (such as labour), and total factor use.

On the other hand, the “institutional” school of thought, often associated with the work of Daron Acemoglu and his collaborators, has emphasized the importance of a country’s institutional environment, where institutions are understood in their economic (and not political) sense in terms of social structures, such as the rule of law or the protection of property rights, that allow economic activity to develop and flourish.<sup>2</sup> As with geography, institutional factors can affect the productivity of single factors, total factor productivity and factor use. One of the most important empirical regularities established by the institutional school is that there is a causal relationship linking national economic institutions

(often measured by an index of protection against expropriation risk) to income per capita. Moreover, a second important empirical regularity is that geography affects per capita income *through* its impact on institutions: once economic institutions are appropriately taken into account, geography arguably no longer has an independent impact on income levels.

Where do trade and finance fit into this picture? In order to organize our thoughts, let us divide the impact of trade and finance on economic growth (leaving development *per se* out of the picture for the time being) into two components. First, there are *direct* effects: trade and finance, through well-established mechanisms, may enhance growth performance. Though the causal evidence at the macro level is often weak (the finance and growth or aid effectiveness literatures are cases in point), there is a corpus of microeconomic evidence that points to productivity enhancing causal effects of trade and finance.

Second, there are *indirect* effects, which operate either through geography or through economic institutions. “Geographic” effects of trade and finance include trading arrangements (such as preferences and regional groupings that help achieve economies of scale), which effectively compensate for geographical disadvantages, or financing options, such as development aid or private-public partnerships devoted to infrastructure projects, which overturn geographic constraints, such as being landlocked.

It became apparent, both during two formal meetings and through numerous exchanges, that all members of the Expert Group on Trade, Finance and Development subscribe, in some form or another, to the institutional school of thought, while acknowledging that geographic factors, and the heterogeneity that they generate among countries, need to be taken into account. All of the policy options that emerged from the Group therefore aim at improving economic institutions—both national and supranational—in some shape or form.

<sup>1</sup> See Sachs et al. (1997).

<sup>2</sup> See Acemoglu et al. (2001).

# 2. Conceptual Framework

Why are institutions a key determinant of income per capita or growth performance? And how can we cogently structure our understanding of institutions, thereby formulating policy options that have some coherent underlying justification and, more importantly, some chance of implementation?

One of the leading explanations for poverty in the world today is that it is partly a product of departures from Pareto-optimality. When markets, firms and households are subject to market, institutional and informational imperfections, Pareto-inferior equilibria obtain, leading to deviations with respect to the first-best optimum. In layman's terms, this means that we could do more with what we already have, but do not. In contrast to the celebrated Schultizian notion of "poor, but efficient" this manner of seeing the world, which to a large extent stems from the seminal work of economists such as Joseph Stiglitz during the 1970s and 1980s, holds that inefficiencies lie at the heart of underdevelopment. If one takes this view as the point of departure, the big questions for the realm of trade, finance and development are the following: what are the main sources of deviations with respect to the first-best optimum, and what can be done to tackle these deviations in concrete policy terms?

This perspective permeates the policy options formulated by the Expert Group. Indeed, all of the options put forward by the group lie squarely within at least one of the canonical types of market, institutional or informational failure. Economics 101 teaches us that there are four types of market failure:

1. *Externalities*, particularly network externalities, including international standards and other problems of coordination failure;
2. *Public goods and common property resources*, which includes the regulatory and enabling environments, as well as other sundry institutions;
3. *Natural monopolies*, in which problems are more efficiently solved at the regional rather than at the national level;
4. *Asymmetric information*, which can be on the side of the country (lack of capacity) or on the side of the firm (unreliable information available to foreign investors).

An extremely important side benefit of the market failure framework is that *all of the policy options that are proposed in what follows correspond to problems that will not be solved by the market mechanism*. Moreover, *prima facie*, the policy proposals are not based on dubious empirical evidence or abstruse theoretical arguments. Rather, and this is a testimony to the remarkable diligence with which group members approached the task at hand, all policy proposals are based on first-hand observation by group members of facts and constraints encountered on the ground.

The Expert Group policy options are outlined in the following section using the market failure conceptual framework. Four options fall under the externalities and coordination failure heading, five under public goods, two under natural monopolies at the regional level, and two under asymmetric information. The paper then concludes by charting an indicative timeframe for consideration and implementation of the options and a proposal on measuring progress.

# 3. Trade and Finance Policy Options: A Tale of Modern Market Failures

## 3.1. Externalities and Coordination Failure

Externalities arise when the private cost or benefit of an activity is not equal to its social cost or benefit. Four recommendations fall under this category. First, there is a need to focus official development assistance (ODA) in a manner that increases its marginal productivity, often through a focus on building institutions that strengthen the enabling environment, as well as by using it to leverage private sources of capital through blended finance. There is also the potential for improving the productivity of domestic financial resources. In basic economic terms, the social benefit of ODA is significantly higher than its private benefit, and current arrangements fail to “internalize” this potentially valuable positive externality, including ODA’s role in helping to ensure a stable macroeconomic environment. Second, tax policy is a key determinant of the behaviour of firms, be they domestic or multinational. In order to increase the capacity for domestic resource mobilization of poor countries, major efforts—both at the international and domestic level—need to be made in terms of revamping policies aimed at combatting “base-erosion and profit-shifting” (BEPS). Third, there is a manifest issue of coordination failure involved when it comes to international standards set by dominant private firms, and which cannot be solved in existing fora such as the World Trade Organization (WTO). The adoption of standards is a typical example of a situation where coordination, in order to achieve a socially efficient outcome, is paramount: in the absence of outside involvement, coordination failure is likely. The gains to adopting well-crafted standards can also be characterized as a situation where there are significant positive network externalities to be internalized. Fourth, there has also been a manifest lack of coordination (and political will) in terms of duty-free and quota-free (DFQF) preferences when it comes to least developed countries (LDCs). The United States, first and foremost, and large emerging powers should therefore grant such access where they have not, and include extended cumulation provisions in their rules of origin to maximize preference utilization by LDCs.

### 3.1.1. Policy Option 1: The strategic use of official development assistance and blended finance

Analysis of trends in financial flows to LDCs reveals that ODA has played a relatively marginal role, in comparison to domestic public and private finance, in underwriting the Millennium Development Goals (MDGs).<sup>3</sup> A review of recent debates and discussions concerning the financing of the Sustainable Development Goals (SDGs) suggests that such trends are not expected to change in any substantive way in the near future. However, ODA enjoys a number of unique developmental advantages over other forms of financial flows with concessionality (if not outright grant) being one of the most important. Thus, strategic use of this scarce resource will be one of the main challenges for LDCs as they position themselves to implement the SDGs in their domestic context. What are the policy options for LDCs in this regard?

It is maintained that the LDCs, alongside their international development partners, need to develop a strategic vision regarding efficient and effective use of ODA in the coming years.<sup>4</sup> The four key building blocks of this new vision are the following:

- Enhanced flows and better quality of ODA for more targeted and results-oriented projects geared towards promoting specific elements of the enabling environment, such as social and economic infrastructure, as well as productivity-enhancing public institutions and productive sectors;
- Greater use of blended finance to scale up investment by leveraging other sources of finance (including private finance), by enhancing project impact (by keeping broader public welfare concerns well in view) and by ensuring financial returns (for private investors and others) by reducing the average cost of capital, funding viability gaps and providing guarantees against various kinds of risks prevalent in low income economies;

<sup>3</sup> In this policy option, the Expert Group is referring explicitly to least developed countries and not to developing countries as a whole.

<sup>4</sup> The think piece authored by Debapriya Bhattacharya (2015) provides the underpinnings for the first three recommendations.

- Creating a more business-friendly policy environment by strengthening national capacities for accelerated domestic reforms, particularly in the financial sector, public expenditure systems, and in the area of the rule of law, thereby ensuring greater financial mobilization and a more efficient use of these resources.
- Emphasize the role that ODA can play in dampening a country's exposure to shocks, by ensuring that at least part of the allocation of conventional ODA depends on structural economic vulnerability; make sure that conventional ODA is not merged with additional resources geared towards LDC adaptation to climate change, based on physical vulnerability indices.<sup>5</sup>

### 3.1.2. Policy Option 2: Mobilize domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system

Developing countries are chronically short of the funds needed to support their development, as the recent United Nations (UN) Financing for Development conference in Addis Ababa highlighted. Increasing the tax raised in developing countries would help plug this financing gap. Half of Sub-Saharan African countries still mobilize less than 15% of their GDP in tax revenues, below the minimum level of 20% considered by the UN as necessary for development. Several Asian and Latin American countries fare little better.

Corporate tax revenue from multinational enterprises (MNEs) is an important source of government revenue in many developing countries, particularly the poorest. As a share of all revenue, corporate income tax (CIT) is actually more important in low and upper middle-income countries than in advanced countries. In Burundi, for example, one company contributes towards nearly 20% of total tax collection. Developing countries lose precious revenue as the result of cross-border tax planning by MNEs. Tackling “base-erosion and profit-shifting” by MNEs could substantially increase tax collection by developing country governments. A recent International Monetary Fund (IMF) paper estimated that developing countries lose US\$213 billion a year, close to 2% of their GDP, from BEPS.

A particular challenge for developing countries arises from “transfer mispricing.” A major portion of global trade takes place within firms, and tax authorities need to be able to discover the transactions that have taken place, assess whether the correct amount of tax has been paid, and collect any tax due. It can be difficult for a tax administration to know about offshore transactions, so a high level of international cooperation between tax authorities is required.

In recent years, substantial international efforts have been made to address BEPS. In 2014, the G20 leaders recognized that “developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity.”<sup>6</sup> The OECD is leading a substantial and unprecedented effort to address major avoidance opportunities that arise under current international tax arrangements. However, developing countries are not central in this process and the OECD has recognized that existing initiatives do not sufficiently include

developing countries or respond to their needs.

Notable progress under the OECD initiative include: (1) a new international “Common Standard” for automatic exchange of information between tax authorities (modelled on the US Foreign Account Tax Compliance Act); and (2) the introduction of country-by-country reporting requirements that will require MNEs to provide specific aggregate information annually to tax authorities in each jurisdiction where they do business, including on the global allocation of income and taxes paid.

For developing countries, more support is needed in two areas. First, to strengthen domestic institutions and legal arrangements in developing countries so that they can implement new international standards and, second, to strengthen the international tax system so it facilitates the work of developing country tax authorities. Concrete steps that could be taken include:

- Increase capacity building efforts on BEPS in developing countries, including by developing toolkits and providing guidance to support the practical implementation of the OECD BEPS measures and other related priority issues (international assistance can be a powerful catalyst for domestic resource mobilization: for example, with modest international support, revenue collection from transfer pricing audits in Kenya has doubled from US\$52 million in 2012 to US\$107 million in 2014);
- Increase the automatic exchange of information between tax authorities, prioritizing the transfer of information to developing country tax authorities;
- Increase the reporting by MNEs to tax authorities, for example by creating a public tracking system that enables ready assessment of progress against international BEPS targets;
- Strengthen the involvement of developing countries in international BEPS initiatives, including those led by the OECD.

Key players for implementation of the above steps include developing country governments, the international business community, the OECD and the IMF, bilateral and multilateral donors, and the UN Tax Committee.

### 3.1.3. Policy Option 3: Guidelines for broadly-used private standards affecting trade

The road to diversification, value addition, and industrialization in a modern economy involves linking up effectively with global supply chains. In some of these, a single firm that dominates the chain sets the technical standards (the iPhone example springs to mind). In others, important purchasing firms act together and establish industry-wide standards (e.g. EurepGAP or GlobalGAP where the “GAP” stands for Good Agricultural Practices, required by big supermarket chains). While little can be done regarding technical standards required of inputs for a firm's specific product, the second type of industry-wide private standards affects a large number of suppliers. These standards may be conflicting or even contradictory. For many firms, especially small and medium-sized enterprises (SMEs) in developing countries, these standards can be difficult to follow and comply with. Moreover, the justification

<sup>5</sup> The think piece written by Patrick Guillaumont (2015) delves into the nuts and bolts of these indicators, as well as their application to ODA, in much greater detail.

<sup>6</sup> OECD. 2014. Secretary General Report to G20 Leaders. Brisbane, Australia

for their existence may not always be sound. For many developing country exporters, private standards are more significant constraints than official sanitary and phytosanitary (SPS) standards and technical barriers to trade (TBT). Fair trade and organic standards, for example, which sometimes provide export opportunities and value added, would be more effective if they were harmonized.

While these difficulties with privately determined standards are akin to those associated with the SPS and TBT Agreements of the WTO, important differences exist. The latter are subject to WTO disciplines and can be challenged, albeit not always effectively. Private standards, on the other hand, even when they affect the whole industry, are self-regulated by the big firms. They are impossible to challenge legally. Assistance to comply with SPS and TBT standards is also a recognized element of Aid for Trade (AfT). However, assistance to understand and comply with private standards does not figure prominently in official aid programmes. This is left to the goodwill of the dominant firms in the supply chain. A related aspect is the nature of contractual agreements between small suppliers and large purchasers.

For private industry-wide standards not to be a constraint but rather a conduit for effective participation in global supply chains, particularly for SMEs, existing limitations can be tackled through:

- Scrutiny and oversight, as well as information dissemination and guidelines concerning private standards, particularly industry-wide ones, that affect large numbers of suppliers; these activities could be undertaken by public bodies (national and international), private sector representatives from developed and developing countries, and civil society; they could be for specific sectors (e.g. food/supermarkets, textiles) and could involve examining whether they are compatible with the requirements of the WTO SPS and TBT Agreements and other international agreements, although it is not clear in the context of voluntary standards whether these constraints could be binding;
- The application of public pressure and the provision of guidelines on harmonizing multiple, rival or conflicting standards employed by large firms or industry-wide standards, including fair trade and organic standards;
- The development of model contracts for selected sectors (e.g. agriculture, mining, forestry, textiles) and the identification of possible “honest brokers” to assist in the formulation of contracts in which developing country firms enter with large established firms;
- The inclusion of compliance with private standards in AfT programmes.

The key players involved include international development organizations (e.g. UNCTAD, UNDP, ITC, UNIDO), the WTO, bilateral and multilateral donors, the World Bank and the IFC, the private sector, civil society and private foundations.

### 3.1.4. Policy Option 4: Expand duty-free and quota-free market access with simple and liberal rules of origin as well as extended cumulation

The US provides trade preferences for about 98% of products from eligible African exporters and around 90% for Haiti, but only slightly over 80% for Asian LDCs. Moreover, the preferences available to Asian LDCs exclude apparel, footwear, and other labour-intensive products, thereby providing very few benefits in practice.<sup>7</sup> US policy-makers should consider eliminating (or radically limiting) exclusions from DFQF market access for relatively competitive exporters, such as Bangladesh and Cambodia. Detailed analysis of US trade data suggests that excluding just a few dozen tariff lines (at the 10-digit level) would shield most African Growth and Opportunity Act (AGOA) and Haitian clothing exports, while eliminating barriers to half or more of Bangladesh’s and Cambodia’s exports. Expanding US preferences to Asian LDCs would also open new opportunities for Afghanistan, Nepal, and other very poor countries. However, even when product coverage is universal (or nearly so), LDCs often confront problems in utilizing preferences because of restrictive rules of origin. Allowing LDCs to incorporate inputs from as broad a “cumulation zone” as possible (e.g. all beneficiaries of a country’s preference programmes plus bilateral trade agreements) would help overcome this obstacle. Three concrete steps proposed by the Expert Group are the following:

- The US and large emerging markets should implement DFQF market access for all LDCs;
- All preference givers should also include extended cumulation provisions in their rules of origin to maximize preference utilization;
- The complexity of product-specific rules of origin should be reduced (the EU has over 500 different rules covering eligibility in addition to economy-wide rules) and, for LDCs, there should be no rules of origin for preferential margins below a threshold of 5% for example.

## 3.2. Public Goods

At the intra-country level, economic institutions—broadly understood to be legal, enabling and regulatory structures that facilitate wealth-enhancing exchange—are the key public good. Public goods and services possess two characteristics. First, they are non-exclusive: once they are provided, they are available to all irrespective of whether or not they were involved in their financing. Second, they are non-rival: the consumption of the good or service by a given agent does not reduce its consumption by others (if the good, service or institutional structure is rival, then we shift to the slightly different concept of a “common property resource”). As such, they are the best example of goods, services or institutional structures that will be underprovided by the market mechanism and where outside intervention is needed.

<sup>7</sup> The think piece authored by Kimberly Elliott (2015) provides the underlying details.

The group formulated five policy options that fall under the public goods heading. First, legal and regulatory reform has to be more development-led. Without a well-functioning legal and regulatory framework, economic activity will not develop, but these structures have to be better adapted to developing country circumstances. Second, given the pro-poor bias of the services sector, a trade facilitation framework for services is urgently required. Third, and related to the previous point, the incentives that determine the sectoral allocation of Aid for Trade funds, which currently tend to ignore the services sector, need to be modified. Fourth, heightened regulatory requirements have led many low-income countries to become functionally cut off from international financial markets by the simple lack of a correspondent (international) bank. Solving this problem in the short run, which is both feasible and relatively low cost, would make a significant contribution to facilitating international trade for firms located in low-income countries. Fifth, a comprehensive global coordination mechanism for trade and supply chain finance is needed. All five proposals are typical examples of institutional public goods that would go a long way towards improving the enabling environment in low-income countries, allowing them to harness the development potential of international trade.

### 3.2.1. Policy Option 5: Development-led legal and regulatory reform

Within institutions such as the WTO, current approaches to trade and development have focused primarily on access to developed country markets through trade preference programmes and special and differential treatment for developing economies—both of which are important but not sufficient to achieve economic diversification and poverty reduction. As a critical element, AfT can help countries and their stakeholders advance legal and regulatory reform, but the initiative alone cannot fully build effective national and regional regulatory institutions and legal processes. What is missing is a process (both top-down and bottom-up) for effectively assessing the development benefits of trade policy at the national and regional levels, addressing non-tariff measures from a development perspective, and applying a more widespread, inclusive, and coordinated system for implementing trade frameworks through legal and regulatory reform.

Trade policy often (though not always) establishes a sound framework for legal and regulatory change in areas such as trade facilitation, SPS measures, TBT, and services, all of which have significant implications for economic development and diversification. Yet there is no clear path for implementing these frameworks in practice, and the impacts of reform in these areas remains largely a “public good” which does not always receive sufficient focus. Many countries face challenges as they seek to adopt and implement an expanding range of legal and regulatory disciplines. In many places, the legal and regulatory process itself is weak, with many companies lacking knowledge of

how the system works or a trusted channel for participating in legal and regulatory reform. Addressing these gaps will help implement both WTO frameworks and regional trade agreements in a development-led manner and increase the effectiveness of these trade mechanisms.<sup>8</sup>

In order to shift the focus to development-led legal and regulatory reform, and address existing gaps such as weak regulatory and legal processes and the lack of knowledge by local firms of these processes, the following steps are recommended:

- Create market-driven platforms to identify where development-led regulatory interventions are needed (across both geographical areas and issues);
- Design tools for assessing and developing untapped market potential;
- Share regulatory best practices, including at the regional level;
- Connect the private sector to domestic, regional and international trade institutions.

The actors involved in this long-term process include legal institutions (academic, non-profit, and private sector), regional economic communities, national ministries and institutions (trade, sector-focused, and legal), multilateral development banks, bilateral and multilateral donors, UN economic commissions and agencies, the WTO, as well as the private sector.

### 3.2.2. Policy Option 6: Trade facilitation framework for services

In support of the United Nation’s adoption of the post-2015 development agenda in September 2015 (the 2030 Agenda for Sustainable Development), and in light of the fundamental contribution which efficiency in the services sector will make to the realization of the SDGs, the Expert Group calls on WTO members to urgently embark on a joint process to establish a Framework for Trade Facilitation in Services.

The impact of the services sector on the process of economic development is relatively neglected, despite the evident and tremendous contribution of the services sector to national and global GDP, employment, and value-added measures of international trade. There was a time when the dominant assumption in the development literature, reflected in policy and practice, was that services were low productivity, low value-added and largely non-tradable. These assumptions are not consistent with the conceptual framework on the modes of delivery established in the WTO’s General Agreement on Trade in Services (GATS). Nor are they borne out by the recent empirical work on the role of services in innovation, multifactor productivity, and trade in value-added. The important WTO work in reaching the Trade Facilitation Agreement has focussed on reducing the costs of trade in goods. Attention now needs to turn

<sup>8</sup> The detailed arguments underlying the following policy recommendations are spelled out in the think piece written by Katrin Kuhlmann (2015).

towards reducing the costs of trade in services. WTO members need to develop a comprehensive Framework for Trade Facilitation in Services, with attendant measurable indicators as in the Trade Facilitation Agreement.<sup>9</sup>

The steady rise of services in all national economies (often referred to as “servicification”) along with the improved ability to measure the extent of the services sector’s contribution to global trade has highlighted how important international competitiveness in services has become for competitiveness in all sectors.<sup>10</sup> Of the various factors that hamper competitiveness in services, and hence hold back export performance in other sectors, regulatory inefficiencies stand out as a key area within governmental power to redress. This requires greater focus on regulatory benchmarking and regulatory cooperation. While this may constitute wishful thinking in terms of implementation, a greater and more concerted government effort is needed to facilitate trade in services by creating a business environment that fosters innovation, investment and growth, allowing economies to move up the value-added chain. Governments should urgently act to address the costs of doing international business in services in order to harness the potential of services to “leapfrog” obstacles to sustainable development.

WTO members should agree to embark on a joint process to establish a Framework for Trade Facilitation in Services. This Framework should encompass both cooperative and negotiating mechanisms, complemented by capacity building and technical assistance, through which the multilateral trading system can spur concerted action on the need, *inter alia*, for:

- Intensified temporary and short stay visa facilitation;
- Enhanced access to finance for trade in services;
- Common guidelines for governance of electronic trade and cross-border data flows;
- Benchmarking of best practices and development of regulatory principles to address cross-border market failures in services sectors.

The Framework should include mechanisms for public-private dialogue with services stakeholders. It should also allow for and encourage implementation of measures on a regional, plurilateral and multilateral basis. Actors involved include the WTO, bilateral and multilateral donors, and the private sector.

### 3.2.3. Policy Option 7: Aid for trade funding for services

Considering the contribution of services trade to the GDP of low-income countries, and the fact that barriers to trade in services are concentrated primarily in policy and regulation, there is a need to fund country studies to address policy and regulatory failures and to develop well-tailored policy and regulatory changes to reverse those failures. Aft funds and ODA in general should be applied to this problem. For LDCs, funds from the Enhanced Integrated Framework (EIF) could be effective in addressing policy and regulatory changes required at the country level. With tourism (measured as travel services and passenger transport) accounting for 30% of global trade in services, tourism stands out as a relatively neglected sector in Aft mechanisms.<sup>11</sup>

Currently, insufficient attention is given to services trade in Aft, especially via multilateral mechanisms, including the EIF. This constitutes a misallocation of funding given the significant development dividends available from services sector growth. World Bank evidence shows that a stronger correlation exists between services growth and GDP than manufacturing growth and GDP, and that services sector growth tends to be pro-poor. The potential for the services sector to contribute to employment growth is even more striking. While aggregate developing country employment data are difficult to obtain, World Bank research shows that the higher the level of employment in the services sector, the higher the female participation rate. A strong correlation also exists between services growth and poverty reduction, chiefly because the services sector generally employs more women; 49 per cent of global female employment is in services. Cutting trade costs for services and increasing Aft in services, including by helping LDCs build supply side competitiveness, should be a high priority.

Boosting growth in the services sector is largely about getting the regulatory setting right, so that public policy objectives can be met without unduly increasing the costs of doing business. Although it is not always fully recognized, there is in general a higher level of government intervention in the services industries than in any other sector. This is partly due to their “invisibility” and to the simultaneity of production and consumption, requiring governments, for public policy reasons, to regulate and set standards for the services suppliers themselves. Regulatory regimes in services are often complex, overlapping and duplicative, and consequently excessively burdensome for business; “one stop” regulatory shops are still no more than an aspiration in many parts of the world. Country studies are required, including mechanisms geared towards helping governments apply the guidance set out in recent World Bank regulatory toolkits designed to boost services competitiveness.

<sup>9</sup> The Trade Facilitation Agreement has yet to enter into force, as it requires two-thirds majority domestic ratification of the WTO membership.

<sup>10</sup> The policy options paper produced by the E15 Expert Group on Services can be referred to for detailed analysis and recommendations regarding services in international trade.

<sup>11</sup> The think piece authored by Frans Lammersen (2015) provides an overview of the salient issues involved in Aid for Trade as well as ways forward.

Concrete steps proposed by the Expert Group include the following:

- WTO members should emphasize the need to utilize AfT funds towards country-specific studies in order to identify and address policy and regulatory failures;
- Dedicated sessions in WTO fora should focus on this topic;
- EIF diagnostic studies for LDC members should concentrate on services policy and regulatory studies.

Parties involved include the WTO, OECD, UNCTAD, ITC, the World Bank, bilateral and multilateral donors, as well as the private sector.

### 3.2.4. Policy Option 8: Ensure correspondent-banking availability

Banks have sharply cut down on their correspondent-banking networks as the costs of regulatory checks such as Know Your Customer (KYC) activities have far outpaced the growth of business potential. Further issues, centred on Anti-Money Laundering, actions have reinforced this trend. Though hard data concerning this issue is scarce, it is believed in the banking community that the sharpest cuts were made in low-income countries, to the point that some of these countries are on the verge of being excluded from international financial networks. The consequence of this financial exclusion is particularly serious when it comes to the exchange of goods and services since, without the ability to exchange information or funds, local companies struggle to enter into the contractual obligations that underpin international trade. The economic development of many low-income countries is therefore severely compromised.

The Group's proposal is that each country should house at least one local bank with a fully-fledged correspondent-banking arrangement with international financial institutions. The key steps involved in bringing this proposal to fruition are:

- Sponsoring/mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group<sup>12</sup> of the process leading to the improvement of the local correspondent bank(s)'s governance structure;
- Have the KYC process validated by the sponsor so that it will be deemed to be sufficient for international regulatory purposes;
- Secure an international ruling to ensure that developed country banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s).

The Chairman of the FSB and the Chief Financial Officer of the World Bank Group have recently endorsed a similar proposal.

### 3.2.5. Policy Option 9: Contribution to Coordinating Efforts for Trade and Supply Chain Finance

It is recommended that a working group be established (within the E15 initiative or another international coalition of experts and institutions) to propose ideas and commission studies that could contribute to improved global coordination efforts in the area of trade and supply chain finance, with the objective of:<sup>13</sup>

- Ensuring appropriate management and dissemination of data, analysis and knowledge;
- Assuring effective advocacy with core stakeholders including regulatory authorities;
- Enabling the development and implementation of effective policy at the national, regional and supranational levels to encourage and facilitate the effective participation of developing countries in global supply chains (there is no policy on trade finance at supranational level, although there may be some intergovernmental arrangements).

## 3.3. Natural Monopolies at the Regional Level

Natural monopolies occur when it is socially efficient, from the cost standpoint, to have a single supplier for a given good or service. Of course, the productive efficiency argument immediately begs the question of how to regulate the ensuing monopolistic structure. For the two policy options that follow, the natural monopoly framework is used in a slightly less restrictive form. The main point is that there are a number of key institutional failures that are more efficiently dealt with at the regional, rather than national, level because of the importance of underlying economies of scale and scope. The proposals involve strengthening regional mechanisms dealing with the regulatory aspects of cross-border financial services, and enhancing, through appropriate incentives, regional aid for trade initiatives.

### 3.3.1. Policy Option 10: Mechanisms for regional regulatory cooperation in financial services

The integration of financial services has received insufficient attention in regional integration efforts. Slow progress in the area of financial integration has made it difficult for banks and other financial entities to operate regionally and support their customers so that they can enjoy the benefits of diversified, more efficient and cheaper financial services. It is important to ensure that the full extent of benefits arising from the economies of scale accrue to those in need of finance, such as micro, small and medium enterprises (MSMEs). Access to finance has been highlighted as the single most important constraint for MSMEs to face the competition of an integrated regional market and connect with the global economy. Key issues to be addressed

<sup>12</sup> The Wolfsberg Group is an association of thirteen global banks which aims to develop frameworks and guidance for the management of financial crime risks, particularly with respect to Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies

<sup>13</sup> Alexander Malaket (2015) has provided a think piece that delves into these issues in greater detail.

include the heterogeneity of regulatory frameworks and restrictive market access, significant checks on the mobility of talent, and constraints on cross-border data flow and offshoring regulatory structures. Three concrete steps to be implemented in various regional fora, with regional development banks as key players in the process, include:

- The creation of regional mechanisms such as regional credit bureaus and rating agencies;
- The facilitation of free data flow and offshoring;
- The standardization of documents and documentation requirements.

### 3.3.2. Policy Option 11: Enhance regional aid for trade

Given the many small markets in developing countries, it is clear that sustained economic growth needs to rely in part on creating larger, more viable markets through the rule-based sharing of resources and production assets. Deepening economic integration via regional cooperation has thus emerged as a key priority in the reform strategies of most developing economies. Regional aid for trade is contributing to this process with commitments that almost tripled from US\$1.2 billion during the 2002–05 baseline to US\$3.1 billion in 2013, although its share is still only 5.5% of total aid for trade.

Regional aid for trade is hampered by many practical complications (including the “tradition” that Diagnostic Trade Integration Studies (DTISs) have always been carried out at the national level), from technical standards to financing issues, while negotiations can be bogged down by poor intergovernmental communications and sometimes a lack of trust among negotiating parties. In fact, regional aid for trade is still insufficiently understood and appreciated in national line ministries and among stakeholders. Moreover, implementing regional strategies is complicated by: membership of overlapping regional organizations; non-implementation of regional agreements; poor articulation within national strategies; and, national and regional capacity constraints. This creates significant problems in terms of ownership, mainstreaming, and aligning national strategies around regional aid for trade priorities. For regional aid for trade programmes to be effective, gaps can be tackled through:

- Involving an “honest broker” (such as regional development banks), or multi-donor programmes (such as Trademark East Africa), or regional initiatives (such as USAID African Trade Hubs), which all offer institutional mechanisms to coordinate regional and sub-regional programmes;
- Having the EIF request that agencies carrying out DTISs move to a regional focus;
- Creating financial incentives such as providing a higher concessionality level for financing regional programmes rather than purely national programmes;
- Building institutional and human capacities to respond

to a wide variety of technical assistance needs covering a range of disciplines, including trade policy, customs, transport, and enterprise development.

The key players involved include regional economic communities, regional development banks, the OECD, UN economic commissions and agencies, the WTO, bilateral and multilateral donors, and the private sector.

## 3.4. Asymmetric Information

Asymmetric information arises when, in a bilateral relationship, one party knows something that the other does not. In the market failure framework, this can be interpreted as there being a missing market for the underlying information, which can lead to severe inefficiencies. The two policy options proposed by the Group under the asymmetric information heading involve: first, strengthening the capacity of developing country governments to negotiate and implement public-private partnerships (PPPs); and, second, providing low-income countries with access to world class advice as well as in-country capacity building geared towards improving their position when it comes to designing and negotiating sovereign bond issuances and restructuring. In both of these fields, low-income countries are currently at a serious informational disadvantage vis-à-vis their international interlocutors.<sup>14</sup>

### 3.4.1. Policy Option 12: Improve technical advice on international economic agreements, including public-private partnerships and sovereign debt contracts

Population growth together with anticipated robust economic growth in low-income countries is increasing demand for electric power, roads, ports, and other physical infrastructure. Financing this infrastructure will require enormous amounts of capital in the coming decades, and only part of this can come from domestic savings or aid. A large volume of foreign savings is potentially available in the pension funds and other financial entities of rich countries. In an effort to tap this source of capital, developing country governments are increasingly turning to PPPs in a bid to attract foreign investment and address this gap. PPPs are now used in more than 134 developing countries, contributing on average towards 15–20% of total infrastructure investment, often involving foreign investors.

The PPP trend looks set to continue, driven in part by the international aid community. As the aid budgets of OECD countries have come under pressure, international donors are turning to the private sector as a strategic partner. PPPs figure prominently in the recently agreed Sustainable Development Goals. World Bank Group support for PPPs, for instance, has increased threefold over the past decade to US\$2.9 billion and now represents 7% of the Group’s lending, investment and guarantees.

Developing country governments face two types of problems in realizing the benefits that can accrue from

<sup>14</sup> The two policy recommendations in this section are presented and substantiated in much greater detail in the think piece authored by Emily Jones (2015).

PPPs. First, despite the potential for high social rates of return, relatively small amounts of private foreign capital are flowing into infrastructure in developing countries. The obstacles are manifold and include: investments that are large and lumpy; construction risks that are unusually high; returns that are reliant on regulatory agencies and the creditworthiness of national governments; returns to capital that are often back-loaded for projects that already have long gestation periods; and, individual infrastructure projects that require complex legal arrangements often involving multiple parties and government agencies.

Second, even when foreign investment does arrive, many PPPs fail in practice to deliver high public benefits. High-quality PPPs are complex to design, negotiate and manage. Developing country governments face very substantial resource and informational challenges. Project developers have greater access to cost and technology information, and information asymmetries put developing country governments at a disadvantage. Many developing countries have insufficient institutional capacity to conduct solid prefeasibility studies or to structure PPP contracts effectively. Moreover, the public sector liabilities triggered by PPPs can be very sizeable (an aspect of PPPs that is often underappreciated yet is very important in the context of rising developing country external debt profiles). Even for World Bank supported PPPs, which are accompanied by substantial institutional backing and expertise, only 62% of projects between 2002 and 2012 rated as satisfactory or better. There is much to learn from these and other successful experiences with PPPs.

Many governments are addressing these concerns and have recently adopted new legislation that provides a general regulatory framework for private investment in infrastructure. Multilateral agencies have made available guarantees to make risks more acceptable. However, beyond this, very little support is available to developing country governments to ensure that PPPs are effectively designed, negotiated, implemented, and evaluated. Relatively few developing countries have developed a framework for competitive bidding for specific projects that would provide for efficient, low-cost investment. This is true not only for infrastructure but also for sectors such as extractive industries.

The Expert Group therefore proposes to strengthen the institutional capacity of developing country governments to design, negotiate, implement and evaluate PPP projects in all sectors, with a particular focus on infrastructure, through the following steps:

- Expand, including through financial support, the access of developing country governments to world-class, independent, impartial and preferably low-cost legal advisory resources to support the design and negotiation of large specific PPP contracts and other complex commercial transactions, building on initiatives such as the African Legal Support Facility housed at the African Development Bank;

- Develop an internationally recognized model PPP framework to guide PPP projects, with a high level of participation by developing country governments; the United Nations Commission on International Trade Law (UNCITRAL) has model frameworks which are being updated: this initiative could be built upon, and the participation of developing country governments greatly strengthened;
- Provide technical resources to support the development of a clear general legal framework; prepare bankable projects that would allow for competitive bidding in a transparent manner; set up rules governing transparency so there can be accountability to oversight organs of government and the general public concerning the use and terms of public resources in PPPs.

Actors involved include developing country governments, UN economic commissions and agencies, multilateral and regional development banks, bilateral donor agencies, and major private sector infrastructure investors.

### 3.4.2. Policy Option 13: Adopt model solvency schemes and restructuring approaches

A striking new trend in international finance is that the governments of many low-income countries are issuing sovereign bonds to finance public debt, often for the first time. Since 2006, 15 countries in sub-Saharan Africa (nearly all low- and low and middle-income countries) have made their debut international bond issues, raising US\$17 billion. Developing country governments are entering uncharted territory as they turn towards international financial markets, which offer credit on harder terms than “traditional” donors and which present new political and economic risks and opportunities. While such bonds can provide funding for large projects, create domestic financing space for the private sector, and can be less costly than local issuance, they also come with refinancing risk, re-pricing risk, and exposure to exchange rate fluctuations. In some countries there has been a deterioration in sovereign balance sheets amid expansionary fiscal stances that have led, in some cases, to the rebuilding of debt stocks. Given that several African borrowers have already undergone restructuring, there are mounting concerns about debt sustainability.

As global yields normalize, there is the very real risk of sovereign debt difficulties in developing countries. Yet there is a dearth of suitable mechanisms for dealing with defaults and restructurings in an orderly, timely and fair manner. In practice, restructurings have been conducted under various frameworks without a consistent approach that normalizes local laws and provides clarity for investors. Issuing governments have found themselves vulnerable to competing interests that carry inherent conflicts of interest. Dependence on the market has led to restructuring outcomes that are counterproductive for the policy initiatives of the sovereign issuer.

As was seen with Argentina, and as developing countries including Zambia have experienced, holdout investors bring further uncertainty to final outcomes, prolonging the restructuring process and further aggravating issuer going-concern risks. Negotiations therefore often commence with competing interests that are not aligned within the framework of long-term sustainability. Derivatives markets, such as that for credit default swaps (CDS), are, for some issuers, distorting the alignment of interest further. The precise legal provisions in bond contracts can make a very substantial difference for developing country governments, and the contracts that underpin many issuances are weak.

To tackle these gaps, certain concrete steps can be taken to harmonize the restructuring process, such as adopting English Law or the UNCITRAL Model Law on Cross-Border Insolvency, which would provide a binding mechanism, eliminating holdouts and bringing international recognition to local courts, thereby eliminating judicial/sovereign risks, and in turn providing a framework for efficient negotiations. In 2014, a group representing the world's largest banks, investors and debt issuers (the International Capital Markets Association) created a new framework for bonds that they hoped would address problems faced during the Argentine debt crisis and Greece's 2012 debt restructuring when holdout investors resisted deals and demanded full payment.

Although many governments quickly adopted the new language, this model legal language has yet to be widely used by developing country governments. In sub-Saharan Africa for instance, with the exception of partial inclusion of these terms in recent issues by Ghana and Ethiopia, no external bonds include the full spirit or letter of the model language. This leaves governments vulnerable to blocking minorities of creditors in the event of an attempted restructuring. Possible reasons that explain why developing country governments may have failed to incorporate this new language include a lack of awareness or fears that investors will be put off buying debt that limits their bargaining power in the event of a default, leading to their reluctance to change their bonds and adopt the new framework.

Developing country governments should be supported to strengthen the legal underpinnings of the bonds they issue. The steps proposed by the Expert Group include:

- Expanding, including through financial support, the access of developing country governments to world-class, independent, and preferably low-cost expert legal advisory services to support the design and negotiation of sovereign bond issuances and sovereign bond restructuring;

- Strengthening the in-house legal resources of central banks and finance ministries in developing countries, as well as local lawyers, through training so as to ensure high quality expertise and advice is available to developing country issuers.

Key players include bilateral development agencies, private philanthropy, UNICTRAL, sovereign and other issuers, local courts, and international courts.

# 4. Next Steps and Measuring Progress

## 4.1. Prioritizing the Policy Options

The policy options put forward by the Expert Group range from ambitious recommendations, in that they will most probably only be feasible in the long term, to options that should technically (if not politically) be easy to implement in the short term. In all cases, however, work on these options should, if possible, start immediately. The policy options can arguably be broken down into three categories over an indicative time horizon, depending on their ease of implementation (including financing constraints).

### 4.1.1. Short-term Options

Three policy options deserve immediate attention in that they can deliver benefits rapidly. First, ensuring correspondent-banking availability depends on mobilizing the international banking community. Similarly, the two capacity-building recommendations (improving technical advice on international economic agreements, including PPPs and sovereign debt contracts, and adopting model solvency schemes and restructuring approaches) are relatively short-term ventures, although they do involve coordinating a broad range of players at the international and domestic levels.

### 4.1.2. Medium-term options

The two services-centred policy options (implementing a trade facilitation framework for services and encouraging AfT funding for services) should be actively pushed in international fora for medium-term implementation. In addition, expanding DFQF and simple and liberal rules of origin (with extended cumulation) to all LDCs depends on nudging the major preference givers. At the regional level, where there may in some instances be a greater convergence of interests, enhancing regional aid for trade and improving mechanisms for regional regulatory cooperation in financial services have a good chance of being adopted—perhaps by having successful regional groupings, such as ASEAN, mentor less successful ones. Providing guidelines for broadly used private standards affecting trade could be taken up by international organizations such as the International Organization for Standardization.

### 4.1.3. Long-term options

Recommendations that involve the revamping of part of the international trade and finance architecture are long-term in nature and require the buy-in of a plethora of players. This is the case for the proposals on making strategic use of ODA and blended finance, and constructing a global coordination mechanism for trade and supply chain finance.

Of course, given their ambition, the payoffs from these proposals, particularly in terms of achieving the SDGs, could be enormous. Finally, two recommendations formulated by the group (fostering development-led legal and regulatory reform, and mobilizing domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system) are also long-term and (largely) need to be implemented at the national level. National economic institutions are notoriously difficult to modify, given the power of existing vested interests. Perhaps a limited number of “test case countries” could be identified in which the political will for such reforms is likely to exist.

## 4.2. Measuring Progress on the Policy Options

A central element of the empirical literature on the impact of institutions on income per capita and growth is the use of protection against expropriation risk as the main indicator for economic institutions. The work of the Expert Group on Trade, Finance and Development suggests that alternative indicators of what the Group would prefer to term the “enabling environment” could be constructed—above and beyond what is already used by various institutions such as the World Bank. Based on the weaknesses in country-specific trade and finance characteristics identified by group members through their proposed policy options, the constituent elements (some of which, such as visa policy, depend on the response of developed countries) of this new index could be the following:

- A Herfindahl index of concentration in the banking sector;
- The existence of a functioning antitrust authority;
- An indicator of fluidity of visa policy, including the ease of obtaining a short-term visa;
- The number of correspondent foreign banks;
- The existence of a national or regional credit bureau and/or a rating agency;
- The legal system under which sovereign bond issuance takes place.

This list of indicators could be complemented with data from the World Bank’s *Doing Business* survey, and standard composite indicator methods could then be applied to arrive at an aggregate index of “institutional readiness.” While the proposed index may be relatively weak on the “trade” side, it is focused on the finance and development nexus. This is work in progress and it is proposed that a working group be set up (by ICTSD and/or the Forum or another interested institution) to operationalize the construction of this index.

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The papers commissioned for the E15 Expert Group on Trade, Finance and Development can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Concrete Steps	Key Players
<b>Market Failure: Externalities and Coordination Failure</b>			
<b>1. Make strategic use of overseas development assistance and blended finance.</b>	Long Term	<ul style="list-style-type: none"> <li>– Enhanced flows and better quality of official development assistance (ODA) for more targeted and results-oriented development geared towards promoting specific elements of the enabling environment, such as social and economic infrastructure, as well as productivity-enhancing public institutions;</li> <li>– Greater use of blended finance to scale up investment by leveraging other sources of finance (including private finance), by enhancing project impact (by keeping broader public welfare concerns well in view) and by ensuring financial returns (for private investors and others) by reducing the average cost of capital, funding viability gaps and providing guarantees against various kinds of risks prevalent in low income economies;</li> <li>– Creating a more business-friendly policy environment by strengthening national capacities for accelerated domestic reforms, particularly in the financial sector, public expenditure systems, and in the area of the rule of law, thereby ensuring greater financial mobilization and a more efficient use of these resources;</li> <li>– Emphasize the role that ODA can play in dampening a country's exposure to shocks, by ensuring that at least part of the allocation of conventional ODA depends on structural economic vulnerability indices.</li> </ul>	Developing country governments, and bilateral and multilateral donors.
<b>2. Mobilize domestic resources in developing countries through stronger domestic tax institutions and a more transparent international tax system.</b>	Long Term	<ul style="list-style-type: none"> <li>– Increase capacity building efforts on base-erosion and profit-shifting (BEPS) in developing countries, including by developing toolkits and providing guidance to support the practical implementation of the OECD BEPS measures and other related priority issues (international assistance can be a powerful catalyst for domestic resource mobilization);</li> <li>– Increase the automatic exchange of information between tax authorities, prioritizing the transfer of information to developing country tax authorities;</li> <li>– Increase the reporting by Multinational Enterprises (MNEs) to tax authorities, for example by creating a public tracking system that enables ready assessment of progress against international BEPS targets;</li> <li>– Strengthening the involvement of developing countries in international BEPS initiatives, including those led by the OECD.</li> </ul>	Developing country governments, the international business community, the OECD and the IMF, bilateral and multilateral donors, and the UN Tax Committee.

Policy Option	Timescale	Concrete Steps	Key Players
<b>3. Provide guidelines for broadly used private standards affecting trade.</b>	Medium Term	<ul style="list-style-type: none"> <li>– Scrutiny and oversight as well as information dissemination concerning private standards, particularly industry-wide ones, that affect large numbers of suppliers; these activities should be undertaken by public bodies (national and international), private sector representatives from developed and developing countries, and civil society; guidelines could be formulated for specific sectors (e.g. food, textiles) and could involve examining whether they are compatible with the WTO Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) Agreements and other international agreements;</li> <li>– Apply public pressure and providing guidelines on harmonizing multiple, rival or conflicting standards employed by large firms or industry-wide standards, including fair trade and organic standards;</li> <li>– Develop model contracts for selected sectors (e.g. agriculture, mining, forestry, textiles) and identifying possible “honest brokers” to assist in the formulation of contracts in which developing country firms enter with large established firms;</li> <li>– Include compliance with private standards in Aid for Trade (AfT) programmes.</li> </ul>	International development organizations (e.g. UNCTAD, UNDP, ITC, UNIDO), the WTO, bilateral and multilateral donors, the World Bank and the IFC, the private sector, civil society, and private foundations.
<b>4. Expand DFQF access to LDCs with liberal rules of origin and extended cumulation.</b>	Medium Term	<ul style="list-style-type: none"> <li>– Urge the US and large emerging markets to implement duty-free and quota-free (DFQF) market access for all LDCs;</li> <li>– Urge the EU to simplify product eligibility requirements;</li> <li>– Urge all preference givers to also include extended cumulation provisions in their rules of origin to maximize preference utilization.</li> </ul>	The United States, European Union and large emerging markets.
<b>Market Failure: Public Goods</b>			
<b>5. Foster development-led legal and regulatory reform.</b>	Long Term	<ul style="list-style-type: none"> <li>– Create market-driven, neutral platforms to identify where development-led regulatory interventions are needed (across both geographical areas and issues);</li> <li>– Design tools for assessing and developing untapped market potential;</li> <li>– Share regulatory best practices, including at the regional level;</li> <li>– Connect the private sector to trade institutions.</li> </ul>	Legal institutions, regional economic communities, national ministries, multilateral development banks, bilateral and multilateral donors, UN economic commissions and agencies, WTO, and the private sector.
<b>6. Implement a trade facilitation framework for services.</b>	Medium Term	<ul style="list-style-type: none"> <li>– Intensify temporary and short stay visa facilitation;</li> <li>– Enhance access to finance for trade in services;</li> <li>– Develop common guidelines for governance of electronic trade and cross-border data flows;</li> <li>– Benchmark best practices and developing regulatory principles to address cross-border market failures in services sectors.</li> </ul>	The WTO, bilateral and multilateral donors, and the private sector.

<b>Policy Option</b>	<b>Timescale</b>	<b>Concrete Steps</b>	<b>Key Players</b>
<b>7. Encourage Aid for Trade funding for services.</b>	Medium Term	<ul style="list-style-type: none"> <li>– WTO members should emphasize the need to utilize Aft funds towards country-specific studies in order to identify and address policy and regulatory failures;</li> <li>– Organize dedicated sessions in WTO fora that focus on this topic;</li> <li>– Encourage Enhanced Integrated Framework (EIF) diagnostic studies for LDC members to concentrate on services policy and regulatory studies.</li> </ul>	The WTO, OECD, UNCTAD, ITC, the World Bank, bilateral and multilateral donors, and the private sector.
<b>8. Ensure correspondent-banking availability.</b>	Short Term	<ul style="list-style-type: none"> <li>– Sponsoring/mentoring by the Bank for International Settlements (BIS), the Financial Stability Board (FSB) or the Wolfsberg Group of the process leading to the improvement of the local correspondent bank(s)'s governance structure;</li> <li>– Have the Know Your Customer (KYC) process validated by the sponsor so that it will be deemed to be sufficient for international regulatory purposes;</li> <li>– Secure an international ruling to ensure that developed countries banks are compelled to maintain a minimum service correspondent-banking network for each enabled country and chosen bank(s).</li> </ul>	The BIS, FSB, Wolfsberg Group, the World Bank, bilateral and multilateral donors, and the banking sector.
<b>9. Coordinate efforts for trade and supply chain finance.</b>	Long Term	<ul style="list-style-type: none"> <li>– Ensure appropriate management and dissemination of data, analysis and knowledge;</li> <li>– Assure effective advocacy with core stakeholders including regulatory authorities;</li> <li>– Enable the development and implementation of effective policy at the national, regional and supranational levels.</li> </ul>	Working group composed of international experts hosted by an interested institution.
<b>Market Failure: Natural Monopolies at the Regional Level</b>			
<b>10. Improve mechanisms for regional regulatory cooperation in financial services.</b>	Medium Term	<ul style="list-style-type: none"> <li>– Creation of regional mechanisms such as regional credit bureaus and rating agencies;</li> <li>– Facilitation of free data flow and offshoring;</li> <li>– Standardization of documents and documentation requirements.</li> </ul>	Regional development banks, parties to regional economic communities and trade agreements, the banking sector.
<b>11. Enhance regional aid for trade.</b>	Medium Term	<ul style="list-style-type: none"> <li>– Involve an “honest broker” (such as regional development banks), or multi-donor programmes (such as Trademark East Africa), or regional initiatives (such as USAID African Trade Hubs), which all offer institutional mechanisms to coordinate regional and sub-regional programmes;</li> <li>– Have the EIF request that agencies carrying out Diagnostic Trade Integration Studies move to a regional focus;</li> <li>– Create financial incentives, such as providing a higher concessionality level for financing regional programmes rather than purely national programmes;</li> <li>– Build institutional and human capacities to respond to a wide variety of technical assistance needs covering a range of disciplines, including trade policy, customs, transport, and enterprise development.</li> </ul>	Regional economic communities, regional development banks, the OECD, UN economic commissions and agencies, the WTO, bilateral and multilateral donors, and the private sector.

Policy Option	Timescale	Concrete Steps	Key Players
<b>Market Failure: Asymmetric Information</b>			
<b>12. Improve technical advice on public-private partnerships.</b>	Short Term	<ul style="list-style-type: none"> <li>– Expand the access of developing country governments to world-class, independent, and preferably low-cost legal advisory resources to support the design and negotiation of large specific PPP contracts and other complex commercial transactions, building on initiatives such as the African Legal Support Facility housed at the African Development Bank;</li> <li>– Develop an internationally recognized model private-public partnership (PPP) framework to guide PPP projects, with a high level of participation by developing country governments; the United Nations Commission on International Trade Law (UNCITRAL) has model frameworks which are being updated: this initiative could be built upon and the participation of developing country governments greatly strengthened;</li> <li>– Provide technical resources to support the development of a clear general legal framework; prepare bankable projects that would allow for competitive bidding in a transparent manner; set up rules governing transparency so there can be some accountability to oversight organs of government and the general public concerning the use and terms of public resources in public-private partnerships.</li> </ul>	Developing country governments, UN economic commissions and agencies, multilateral and regional development banks, bilateral donor agencies, and major private sector infrastructure investors.
<b>13. Adopt model solvency schemes and restructuring approaches.</b>	Short Term	<ul style="list-style-type: none"> <li>– Expand the access of developing country governments to world-class, independent, and preferably low-cost expert legal advisory services to support the design and negotiation of sovereign bond issuances and sovereign bond restructuring;</li> <li>– Strengthen the in-house legal resources of central banks and finance ministries in developing countries, as well as local lawyers, through training so as to ensure high quality expertise and advice is available to developing country issuers.</li> </ul>	Bilateral development agencies, private philanthropy, UNICTRAL, sovereign and other issuers, local courts, and international courts.

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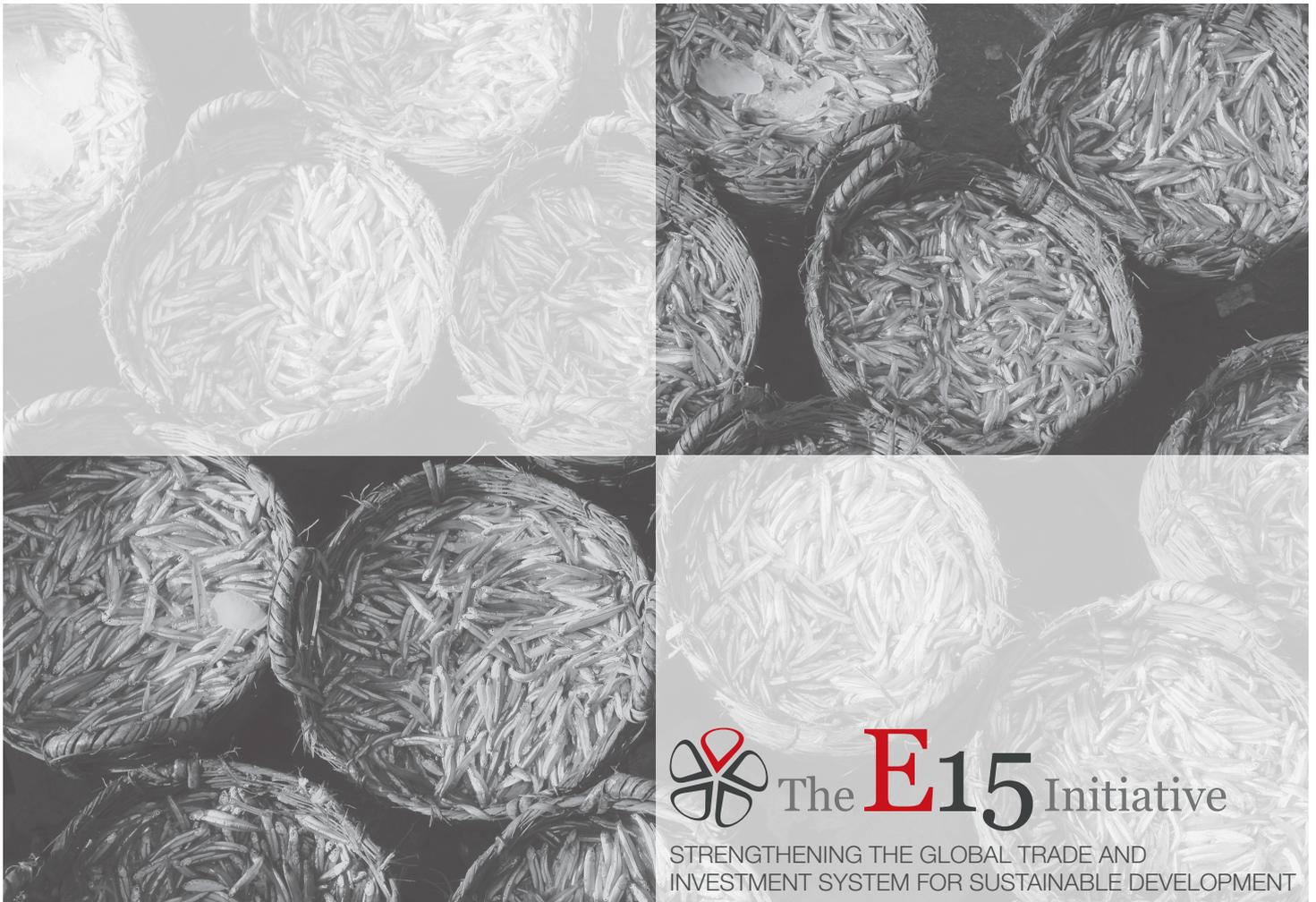
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# Trade Policy Options for Sustainable Oceans and Fisheries

Policy Options Paper



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# Trade Policy Options for Sustainable Oceans and Fisheries

U. Rashid Sumaila

on behalf of the E15 Expert Group on Oceans, Fisheries and the Trade System

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Oceans, Fisheries and the Trade System. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15 Initiative and authored by group members. U. Rashid Sumaila was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

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# Abstract

With 37% of fish harvest exported as food for human consumption or in non-edible forms, trade policies and measures constitute an essential part of the overall policy framework needed to support sustainable environmental and human development priorities connected to oceans and fisheries. The Ocean is a vital component of the earth's system and contributor to the well-being of human society. Ensuring ocean sustainability has become a global challenge, as unsustainable practices threaten marine biodiversity, fish stocks, food security and livelihoods. The objective of the paper is to provide fresh thinking on the key challenges facing the world's oceans and fisheries and identify policy options and reform opportunities for the global trade system to support a transition towards sustainable fisheries and healthier oceans. The policy options are structured under three work packages: closing

the market for illegal, unreported, and unregulated (IUU) fishing; disciplining fisheries subsidies; and addressing tariff and non-tariff measures. In the IUU and subsidies work packages the aim is to ensure that trade does not undermine the environment. The main objective of the third package is to ensure that international markets function effectively and that they enable developing country producers to build sustainable fisheries and move up the value chain. While there is a preference for multilateral approaches, the paper proposes options that may compromise on multilateralism in the short term in order to facilitate the building of broader solutions in the system in the longer term. The three work packages nevertheless provide an innovative and inclusive agenda for domestic reform and international cooperation geared toward securing sustainable oceans and fisheries worldwide.

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Abbreviations	
ACP	Africa, Caribbean, and the Pacific Group of States
AfT	Aid for Trade
ASCM	Agreement on Subsidies and Countervailing Measures
ASEAN	Association of Southeast Asian Nations
AU-IBAR	Inter-African Bureau for Animal Resources
CARICOM	Caribbean Community and Common Market
CITES	Convention on International Trade and Endangered Species
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECOWAS	Economic Commission of West African States
EEZ	exclusive economic zone
FAO	Food and Agriculture Organization
FIP	fishery improvement project
G20	Group of Twenty major economies
GATT	General Agreement on Tariffs and Trade
GSP	Generalized System of Preferences
HS	Harmonized System
IFPRI	International Food Policy Research Institute
IGO	intergovernmental organization
ITC	International Trade Centre
ITLOS	International Tribunal for the Law of the Sea
IUU	illegal, unreported, and unregulated
LDC	least developed country
MEA	multilateral environmental agreement
MFN	most favoured nation
MSC	Marine Stewardship Council
NEPAD	The New Partnership for Africa's Development
NGO	non-governmental organization
OECD	Organisation for Economic Co-Operation and Development
PPM	process and production method
PSMA	Port State Measures Agreement
REC	Regional Economic Community
RFMO	regional fisheries management organization
ROO	rules of origin
RTA	regional trade agreement
SDGs	Sustainable Development Goals
SPS	sanitary and phytosanitary
SRFC	Sub-Regional Fisheries Commission
SSF	small-scale fisheries
TBT	technical barrier to trade
TFTA	Tripartite Free Trade Area
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UNCLOS	United Nations Convention on the Law of the Sea
UNFSS	United Nations Forum on Sustainability Standards
WCO	World Customs Organization
WTO	World Trade Organization

# Executive Summary

Trade in fish and fishery products is extensive and shapes global production and consumption patterns. An estimated 37% of fish harvest is exported as food for human consumption or in non-edible forms. Trade policies and measures thus constitute an essential part of the overall policy framework needed to support sustainable environmental and human development priorities connected to oceans and fisheries.

The Ocean is a vital component of the earth's system. It is home to over half of the earth's biodiversity and contributes significantly to the well-being of human society. Oceans provide half the planet's oxygen and fix a quarter of the world's carbon dioxide. Fisheries (marine, freshwater and aquaculture) provide three billion people with up to 15% of the animal protein they consume and generate employment for at least 140 million people worldwide, including some of the most vulnerable. The ability of fisheries to continue to deliver these functions depends on their sustainable use. Ensuring ocean sustainability has become a global challenge, as unsustainable practices threaten marine biodiversity, fish stocks and livelihoods.

To address the role of trade policies, ICTSD, in partnership with the World Economic Forum, convened a group of world experts under the broader E15 Initiative. The objective was to provide fresh thinking on the key challenges facing the world's oceans and fisheries, including aquaculture, and identify policy options and reform opportunities for the global trade system to support a transition toward sustainable fisheries and healthier oceans. These options are structured under three work packages.

## Challenges Facing Oceans and Fisheries

Several marine fisheries management and governance institutions have been established to support the sustainability of fisheries at the local, national, regional and global level. While there are examples of success, these attempts have failed to meet the challenge of balancing current and future use of fisheries in many regions due to the prioritization of short-term gains, the lack of precautionary and ecosystem-based management, and the weakness of enforcement mechanisms often leading to stocks being overfished. This undermines the long-term interests of many communities.

### *Illegal, unreported, and unregulated fishing*

Illegal, unreported, and unregulated (IUU) fishing is still common in many parts of the world. The UN General Assembly views IUU fishing as one of the biggest threats to sustaining fish stocks globally. It occurs not only in the high seas but also within exclusive economic zones that are poorly managed. IUU fishing is a barrier to the effective management and sustainability of oceans and fisheries and also represents a major loss of potential revenue and wealth for many coastal developing countries. Trade-related policy measures have great potential to contribute to solving this source of unsustainability in fisheries.

### *Fisheries subsidies*

While reliable and accurate data remains sparse, partly due to a lack of transparency, total fisheries subsidies are estimated to amount to approximately US\$35 billion, which constitutes 30–40% of the landed values generated by wild fisheries worldwide. Capacity-enhancing subsidies, which tend to promote disinvestment in the resource by motivating overcapacity and overfishing, make up the highest share at about US\$20 billion.

### *Tariffs and non-tariff measures*

Tariff and non-tariff measures shape fish processing and trade and are widely employed by countries. From a sustainable development perspective, the question of tariff liberalization presents a number of policy tensions that the policy options aim to reduce. In addition, while tariff barriers to fish products have gradually fallen, non-tariff measures, which include public and private standards, are growing in significance and raise new challenges for developing countries. Although the impact of trade on fisheries will be context-specific, at a global level, trade measures can influence sustainable outcomes as part of a coherent policy framework.

## Prerequisites for Trade-Related Measures in Fisheries to Succeed

*Inclusiveness and Fairness:* The oceans are interconnected. Fish do not respect national boundaries as they swim, and fish trade, by nature, involves more than one country. This implies that to employ trade-related measures in support of healthy oceans and sustainable fisheries, international collaboration that is fair and inclusive is needed.

*Transparency:* To achieve international collaboration and joint action, the availability of good quality information is fundamental both in the design of initiatives and in

their implementation. Special effort is needed to improve transparency with respect to fisheries by bringing private sector and public information together in integrated data platforms.

*Policy Coherence:* This cross-cutting element is necessary because many of the issues to be grappled with and the trade-related measures identified herein are both interrelated and interconnected.

*Capacity Building:* People make things happen and well-trained and equipped people make things happen better. The design and implementation of effective trade-related measures requires a concerted global effort to train people who can ensure the effective implementation not only of trade measures but also other sustainable development policies.

## Trade-Related Policy Options

The paper proposes policy options divided into three work packages: closing the market for IUU fish catch, disciplining fisheries subsidies, and addressing tariff and non-tariff measures. While the IUU and subsidies work packages are aimed at ensuring that trade does not undermine the environment, the main objective of the third package is to ensure that international markets function effectively and that they enable developing country producers to build sustainable fisheries and move up the value chain

### *Work Package 1: Closing the market for IUU fish catch*

The goal is to progressively close down international trade in IUU fish products, taking into account the implications of adjustment for low-income countries. One way to work towards eliminating IUU fishing is to establish means to make it difficult for fish products from IUU fishing to enter the market. **Policy Option 1:** Build consultative, effective and coordinated unilateral import measures; **Policy Option 2:** Create a network of regional measures to address IUU fish trade; **Policy Option 3:** Develop a system of multilateral instruments on trade in IUU fish products; **Policy Option 4:** Support expansion of private sector schemes.

### *Work Package 2: Disciplining fisheries subsidies*

The aim is to improve transparency with respect to global fisheries subsidies and build momentum towards a multilateral agreement on subsidy reform. The very high level of annual capacity-enhancing support advanced to the fisheries sector is a key driver of unsustainability that the options would seek to discipline. **Policy Option 5:** Strengthen reporting requirements for fisheries subsidies; **Policy Option 6:** Core group of countries adopts fisheries subsidies disciplines; **Policy Option 7:** Establish multilateral disciplines built step-wise and bottom-up based on a plurilateral deal and negotiation of the remaining ambition gap; **Policy Option 8:** Establish multilateral disciplines built on areas of agreement in WTO negotiations and those focused on widely-acknowledged capacity-enhancing subsidies; **Policy Option 9:** Align incentives by focusing international subsidy negotiations on international fish stocks.

### *Work Package 3: Tariffs and non-tariff measures*

This package addresses specific issues in international fisheries trade, particularly in relation to developing country producers. Given the heterogeneous nature of fisheries production and its socioeconomic and ecological variables, governments will need to work case-by-case to ensure that they integrate the impact of tariff liberalization in a sustainable manner. **Policy Option 10:** Differentiate between capture and aquaculture fish in the Harmonized System (HS) of tariff codes; **Policy Option 11:** Support preference-dependent countries to adapt by negotiating more flexible rules of origin in preference schemes; **Policy Option 12:** Support preference-dependent countries to adapt by providing assistance to reach standards; **Policy Option 13:** Ensure coherence between private standards and TBT Standards Code; **Policy Option 14:** Link mutual recognition systems for standards applicable to fish products.

## Priorities and Next Steps

Priority trade-based policy solutions include the reform of harmful subsidies and efforts to restrict the global fisheries market to sustainable and legal products. While there is a preference for multilateral approaches, the paper proposes options that may compromise on multilateralism in the short term in order to facilitate the building of broader solutions in the system in the longer term. In addition, special effort is needed to improve transparency with respect to fisheries by bringing private sector and public information together in integrated data platforms. This would help inform reform efforts and should be prioritized.

A sectoral trade agreement on sustainable fisheries could address a number of different aspects of fisheries trade, including tariff and non-tariff measures, IUU fishing and fisheries subsidies. Aid for Trade and other development finance tools can be used not only to catalyse agreement and action but also to mitigate the potential negative impacts of these policies on small-scale fisheries. Such a sectoral initiative could be developed either within the WTO as a plurilateral agreement or within the framework of regional trade agreements.

The following table provides an indicative time scale for implementing the policy options under the three work packages. Short-term policy options are those that we estimate could be implemented within one to three years; medium and long-term options are estimated to take between three to five and five to ten years respectively. It is expected that medium to long-term policies would likely have bigger impacts in terms of their effect on the sustainability of fisheries. It should be noted, however, that this categorization reflects a combination of prescriptive and normative assessments of what is feasible.

	<b>Closing the market for IUU fish catch</b>	<b>Disciplining fisheries subsidies</b>	<b>Tariff and non-tariff measures</b>
<b>Short term</b>	Policy options 1 & 4	Policy options 5 & 6	Policy options 10, 11 & 12
<b>Medium term</b>	Policy option 2	Policy option 8	Policy option 13
<b>Long term</b>	Policy option 3	Policy option 7 & 9	Policy option 14

# 1. Introduction

Healthy oceans and sustainable fisheries are an essential part of sustainable development as they contribute significantly to the well-being of human society. A large proportion of global fish production is traded internationally with trade-related policies playing a critical role in shaping production and consumption patterns. As such, trade policies and measures constitute an essential part of the overall policy framework needed to support sustainable environmental and human development priorities connected to oceans and fisheries.

To address the role of trade policy frameworks in promoting healthier oceans and more sustainable fisheries, the E15Initiative convened a group of leading experts from around the world. The main objective was to provide fresh and evidence-based thinking on the key challenges facing the world's oceans and fisheries and identify policy options and reform opportunities for the global trade system to support a transition toward more sustainable fisheries and healthier oceans.

This paper provides a brief summary of the main challenges facing oceans and fisheries, including aquaculture, and outlines trade policy options to address the identified challenges. The analysis and recommendations draw heavily on the overview paper (Sumaila et al. 2014) and think pieces (Asche 2015; Campling 2015; and Young 2015) published by the E15 Expert Group as well as discussions that took place during meetings held in 2014 and 2015.

The ocean and coastal biomes provide us with food, fuel and biological resources, climate regulation and biogeochemical processes (e.g. carbon dioxide uptake and carbon storage), and cultural services (e.g. recreational, spiritual and aesthetic enjoyment) while supporting other indirect ecosystem services, such as nutrient cycling (Gattuso et al. 2015). In particular, fish support human well-being through employment in fishing, processing, and retail services (FAO 2014), as well as food and nutritional security for the poor and rich alike (Srinivasan et al. 2010).

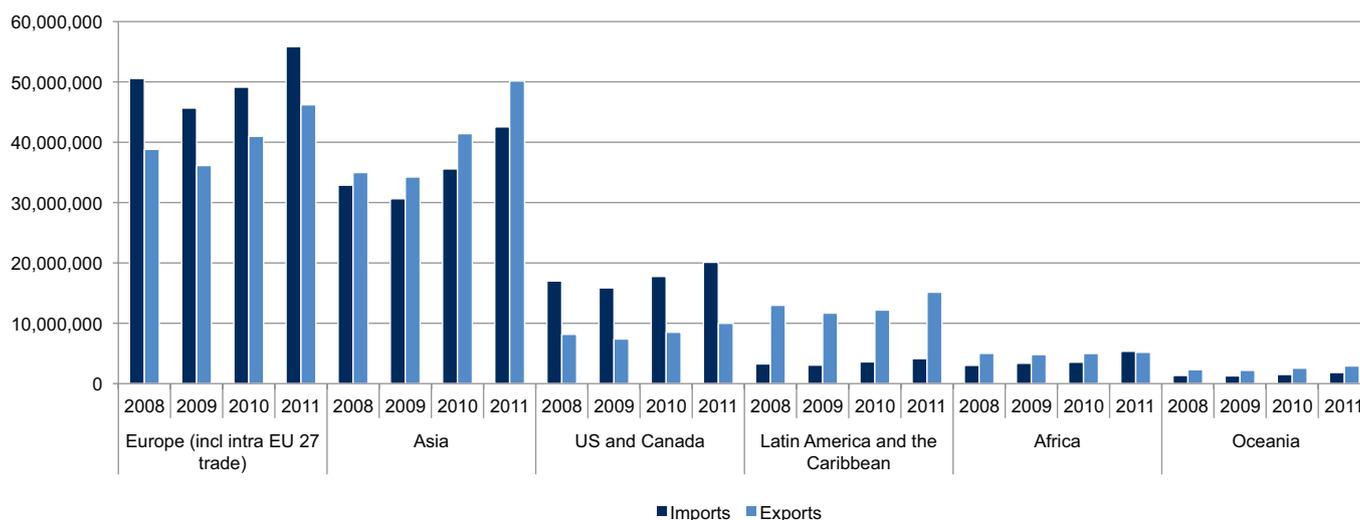
Achieving healthy oceans has proved difficult in the period since after the Second World War, as they suffer from the tragedy of the commons resulting in overfishing, pollution, and habitat destruction. Global warming, ocean acidification and deoxygenation are new threats (Gattuso et al. 2015). Combined with the long-standing threats, these new issues are creating formidable challenges to this important source of ecosystem services, especially with respect to the ability of future generations to enjoy these services.

The rapid expansion of aquaculture has also contributed significantly to the provision of fish protein to many in the world (Asche 2015), especially in Asia where the bulk of the farmed fish are herbivorous. Not surprisingly, this expansion has raised concerns about its environmental impact and highlighted the need to continue ongoing efforts to achieve sustainable aquaculture worldwide (Cao et al. 2015).

Trade in fish and fishery products is extensive (Figure 1). Many fisheries are exposed to the pressures of international demand and competition for supply. In 2012, 37% of fish harvest was exported as food for human consumption or in non-edible forms (FAO 2014). The European Community, Asia (primarily Japan and China) and the United States were among the largest traders of fish (Swartz et al. 2010). According to the FAO (2014), in 2012, developing countries accounted for 54% of the world's fisheries exports by value and 60% by volume (live weight). Today, several developing countries are major players in the sector as a result of their integration into the global value chains of fisheries production (Young 2011). These value chains are extremely varied and can be extensive. Improvements in technology and falling transport costs have allowed countries like Thailand and China to specialize in particular segments of the fisheries value chain, for example in importing raw material, processing (or even re-processing), and exporting to third markets (FAO 2014).

Some experts argue that increased international fish trade would benefit development and thus alleviate poverty. Others argue that the export of fish has potentially negative effects on food security and local livelihood options, particularly for poor people (Ruddle 2008). The pro-trade stance argues that the income generated by fish exports in the exporting country can contribute to economic growth (Bostock et al. 2004). Opponents of this view maintain that revenue from fish trade often fails to materialize (Petersen 2003), that export-oriented industry development results in local job loss (Kaczynski and Fluharty 2002), or that the economic gains are captured by elites and do not benefit the national fisheries sector or individuals connected with it (Wilson and Boncoeur 2008). Asche et al. (2015), on the other hand, demonstrate that developing countries, as a group, tend to benefit from trade with developed countries in seafood. Further, Smith et al. (2010) argue that the reasons local populations may not derive benefits from trade are more related to domestic governance issues rather than trade *per se*. Whatever one's position in this debate, the implication is that trade policies need to be designed with the local context in mind and by taking into account their impact on small-scale fisheries, especially in developing countries.

**Figure 1: Fishery Trade Flows by Region (2008-11) US\$ '000**



Source: FAOSTAT database

Although the impact of trade on fisheries will be context-specific, at a global level, the significant volume of trade in fish and fish products suggests that trade measures can contribute, as part of a coherent policy framework, to sustainable outcomes.

In support of sustainable oceans and fisheries, we provide policy options concerning trade measures to discipline subsidies, reduce illegal, unreported and unregulated (IUU) fishing, and address tariff and non-tariff measures that impact on market access. There are solid justifications for selecting these three areas for analysis. Subsidies to the fishing sector are large relative to the gross revenues the sector generates and it is theoretically established that some fisheries subsidies are detrimental because they stimulate overcapacity and overfishing (Clark et al. 2005). Empirical evidence of these effects is beginning to appear in the literature (e.g. Heymans et al. 2011). IUU fishing is similarly widespread around the world with serious conservation, economic and social consequences (Agnew et al. 2009). In 2011, the UN General Assembly cited IUU fishing as one of the biggest threats to sustaining fish stocks globally (UNGA 2011). Furthermore, the Sustainable Development Goals (SDGs) and Third International Conference on Financing for Development mention illegal fishing and fisheries subsidies as priorities for global action (UN 2014, 2015). It is therefore important that both harmful subsidies and IUU fishing be eliminated, and trade policy measures clearly have a role to play. Tariff and non-tariff measures shape fish processing and trade and are widely employed by countries. From a sustainable development perspective, the question of tariff liberalization presents a number of policy tensions, which we explore below.

Even though the focus of this paper is primarily on industrial fisheries, we recognize that our proposed trade policy options will have both direct and indirect effects on small-scale fisheries (SSF), which need to be taken into account. For example, SSF producers seeking to enter the export market may face the burden of proving the legality of their catch. A similar challenge exists with respect to sanitary and phytosanitary (SPS) regulations, which are seen as a major barrier to some developing country fisheries entering the export market.

Moving from the current pattern of resource use toward more sustainable models will require better fisheries management and a reform of subsidies and economic incentives. Fisheries are a crucial source of employment and income. They are also central to the culture of nations and communities. Reform of the socio-economic aspects of fisheries is thus as important as managing the biology of the relevant ecosystem. The change to more sustainable harvesting will be particularly difficult to achieve without identifying alternative means of sustenance and livelihoods (e.g. recreational fishing and employment opportunities in other sectors). The benefits, however, could be substantial. The sustainable management of fisheries resources would help ensure that these livelihoods can be pursued. It would also help support the resilience of affected communities to the impacts of climate change.

# 2. New Challenges

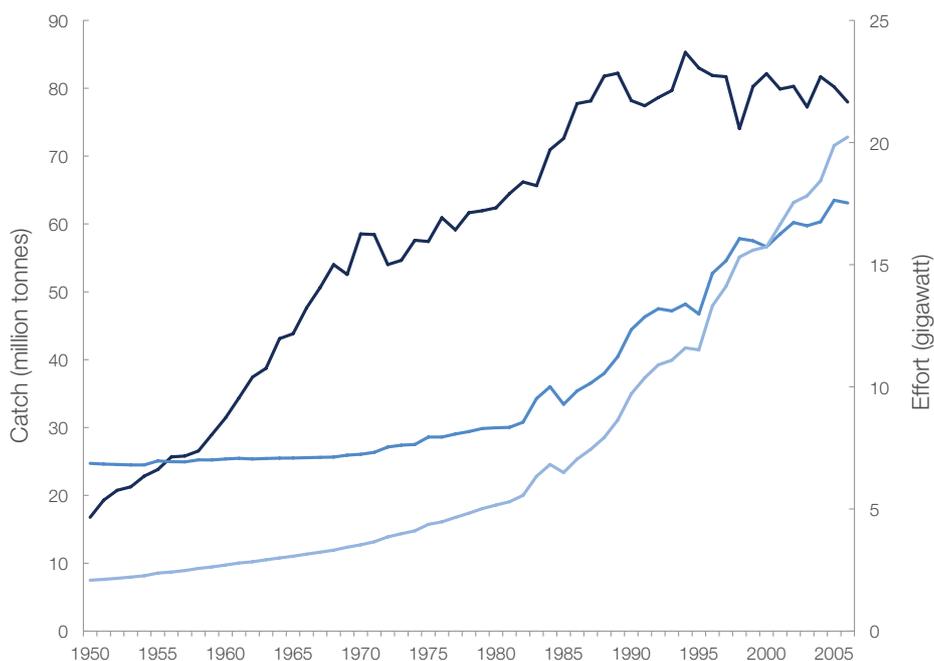
## 2.1. The Impact of Overfishing on Wild Stocks

Fishing effort targeting *wild fish* stocks increased rapidly following World War II, particularly off the coasts of Europe, North America, and Japan. The spatial coverage of global fishing effort also expanded rapidly to cover most of the world's oceans by 2005 (Swartz et al. 2010), with an increase in overall fish catches continuing until 1996 when they peaked at about 86 million tonnes. The expansion of the geographic extent of fishing has been accompanied by a ten-fold increase in the global fishing effort since 1950 (Figure 2); a figure that rises to 25-fold for Asia over the same period. Overall, the decline in global catch per unit effort suggests a decrease in the biomass of many fished populations, likely by more than 50% (Watson et al. 2013). The reasons for this large increase in fishing effort are many, with ineffective management, technological innovation and the provision of subsidies chief among them. The expansion of capacity has been such that the World Bank and the FAO (2009) estimate that the total global catch could be achieved with only half of the effort actually employed.

The observed increase in fishing effort and catch has impacted wild fish stocks and their habitats negatively (Pauly et al. 2002). These impacts have significantly affected marine ecosystems and the health of oceans (Halpern et al. 2012). While the focus in this note is on the relationship between fishing and trade, it is worth noting that there are other human-generated impacts on ocean and freshwater

ecosystems, including the generation of greenhouse gases that lead to climate change and ocean acidification (Gattuso et al. 2015); pollution from land-based and marine sources; coastal development; shipping; and the petro-chemical industry. An additional dimension to the challenge of sustainable fisheries management is therefore the extent to which other ocean activities impact the health of fish stocks. It is the synergistic effect of these multi-stressors, together with irresponsible fishing and aquaculture practices, which have resulted in the observed negative impacts on freshwater, coastal, and marine ecosystems. Hence, to tackle ecosystem degradation and ensure the sustainability of fisheries, we need a more comprehensive ecosystem approach to governance and policy reforms (Pikitch et al. 2004). We also require cooperative policy responses from the international community in more effective ways than seen before (Sumaila et al. 2011). Responses will need to deploy all available approaches and tools at different scales (local, national, regional and global) via governments, non-governmental organizations, the private sector and individual actions. The degree of trade exposure of many fisheries suggests that trade policy measures could contribute to this effort. The shift to more sustainable fisheries could integrate the use of trade policy instruments (such as the proposals included herein) as a complement to the management and governance of fisheries resources themselves. Trade measures could also help support important approaches to fisheries management, such as precautionary and ecosystem-based management (Pikitch et al. 2004).<sup>1</sup>

**Figure 2:** Global Trends in Fisheries Catch and Fishing Effort (1950-2006)



Source: Watson et al. 2013

<sup>1</sup> Ecosystem-based fishery management reverses the order of management priorities to start with the ecosystem rather than the target species, with the overall objective of sustaining healthy marine ecosystems and the fisheries they support.

## 2.2. The Growth in Aquaculture Production

The FAO (2014) reports that in 2012 total global *aquaculture* production was 66.7 million tonnes, of which Asia alone produced 58.9 million tonnes. The sector has come a long way: aquaculture contributed just 3% of total fish supply in 1970 (Figure 2). By 2014, the world’s fish farms supplied more food fish than wild landings, although the total global catch of wild fish is still larger, owing to non-food uses such as reduction to fishmeal (Figure 3). It should be noted that these numbers may be skewed in favour of aquaculture because the official statistics as reported by the FAO do not capture the wild fish catches of many small-scale fisheries around the world.

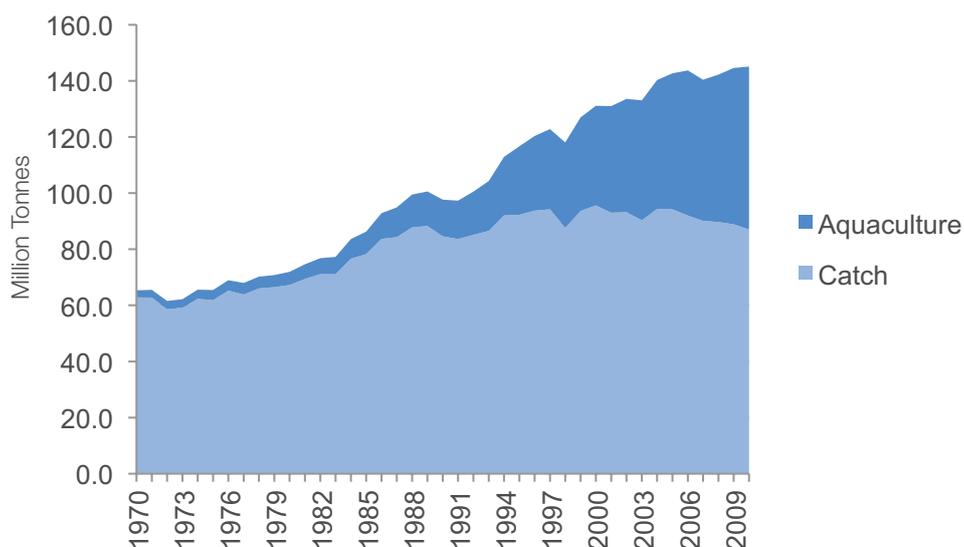
This huge increase in aquaculture production in recent years has its benefits but also its costs. It has helped to fill the gap between growing demand and stagnant landings from wild fish stocks. In contrast, the increase in the production of fish in farms has resulted, in certain instances, in environmental impacts that have caused concerns among experts. A recent study by the FAO, the International Food Policy Research Institute (IFPRI), and the World Bank projects that aquaculture production may reach 93.6 million tonnes in 2030—i.e. a 50% increase from the production level in 2011 (Msangi et al. 2013). Some analysts, however, have called for caution with respect to sectoral growth expectations, as growth is unlikely to continue at this pace in the long term, owing to constraints such as competition for space and water and problems related to disease and the environment. (e.g. Liu and Sumaila 2008).

There are concerns regarding the effect of fish farming on the sustainability of wild fish stocks. These include: derived demand for fish oil and meal; food safety and health issues related to fish farm products; and the potential negative impacts on the environment via wastes from cage cultures, farm escapees and invasive species, genetic pollution, disease and parasite transfer, and habitat modification. It is crucial that coherent policies and measures are put in place to ensure that fish farms are operated in a manner that minimizes impacts on wild fish stocks and the environment. In this effort, trade-related policies can play an important role, given the high proportion of fish and fish products from farms (e.g. shrimp) that are traded internationally. The paper puts forward specific proposals below. At a general level, trade policy can be used to support sustainable aquaculture production through the import and transfer of technology and know-how for example.

## 2.3. Illegal, Unreported, and Unregulated Fishing<sup>2</sup>

Although the definition of IUU fishing is controversial, for present purposes we use that provided in paragraph 3 of FAO (2001). It states that *Illegal fishing* refers to activities: (i) conducted by national or foreign vessels in waters under the jurisdiction of a State, without the permission of that State, or in contravention of its laws and regulations; (ii) conducted by vessels flying the flag of States that are parties to a relevant regional fisheries management organization (RFMO) but operate in contravention of the conservation and management measures adopted by that organization and by which the States are bound, or relevant provisions of the applicable international law; or (iii) in violation of national laws or international obligations, including those undertaken by cooperating States to a relevant regional fisheries management organization. *Unreported fishing*

**Figure 3: Total Global Production of Seafood from the Wild and Aquaculture (1970-2010)**



Source: FAO 2014

<sup>2</sup> IUU fishing is a challenge that affects wild fisheries but not aquaculture. Hence, the discussion here only relates to the former.

refers to fishing activities: (i) which have not been reported, or have been misreported, to the relevant national authority, in contravention of national laws and regulations; or (ii) undertaken in the area of competence of a relevant regional fisheries management organization which have not been reported or have been misreported, in contravention of the reporting procedures of that organization. Finally, *Unregulated fishing* refers to fishing activities: (i) in the area of application of a relevant regional fisheries management organization that are conducted by vessels without nationality, or by those flying the flag of a State not party to that organization, or by a fishing entity, in a manner that is not consistent with or contravenes the conservation and management measures of that organization; or (ii) in areas or for fish stocks in relation to which there are no applicable conservation or management measures and where such fishing activities are conducted in a manner inconsistent with State responsibilities for the conservation of living marine resources under international law.

Illegal, unreported and unregulated fishing is still common in many parts of the world. It occurs not only in the high seas (Sumaila et al. 2015), but also within exclusive economic zones (EEZs) that are not well managed (Agnew et al. 2009).<sup>3</sup> IUU fishing is a barrier to the effective management and sustainability of oceans and fisheries. It also represents a major loss of potential revenue and wealth for many coastal developing countries.<sup>4</sup> At its root, IUU fishing occurs because of the significant overcapacity that exists in the world's fishing fleet; growing demand for fish which boosts prices; inadequate fisheries management (especially monitoring and surveillance of fishing grounds); and the low penalties usually meted out when fishers are apprehended fishing illegally combined with low probabilities of being caught. In many cases, it "pays" not to stick to the rules. It is therefore important that IUU fishing is addressed in a comprehensive manner, including through cooperation with all stakeholders. Trade-related policy measures have great potential in contributing to solving this problem.

It should be noted that "illegal," "unreported," and "unregulated" catch represent different kinds of violations of fisheries governance rules. The legal and economic space for trade in "unregulated" catch appears to be narrowing. The recent advisory opinion issued by the International Tribunal for the Law of the Sea (ITLOS) suggests that flag states have an international legal obligation to exercise due diligence to ensure their vessels fishing in another country's EEZ are not engaged in IUU fishing.<sup>5</sup> Trade measures, such as those imposed by the EU, that demand catch documentation as a condition of market access, essentially require that catch be from a regulated (and documented) fishery. The expansion of similar kinds of unilateral import

measures, as suggested below, could gradually reduce the market for IUU fish catch if they inspire multilateral action that involves all players. For the purposes of this paper, we discuss trade measures that would require proof that fish products were sourced legally and not through IUU fishing.

Private sector efforts to address IUU fishing use supply chain traceability and verification (and the critical step of auditing) to exclude IUU catch from supply chains. These efforts are highly effective in some cases (e.g. the Barents Sea). But they are only as effective as the share of the market they hold: control documents required by just a few buyers may simply drive products to other buyers.

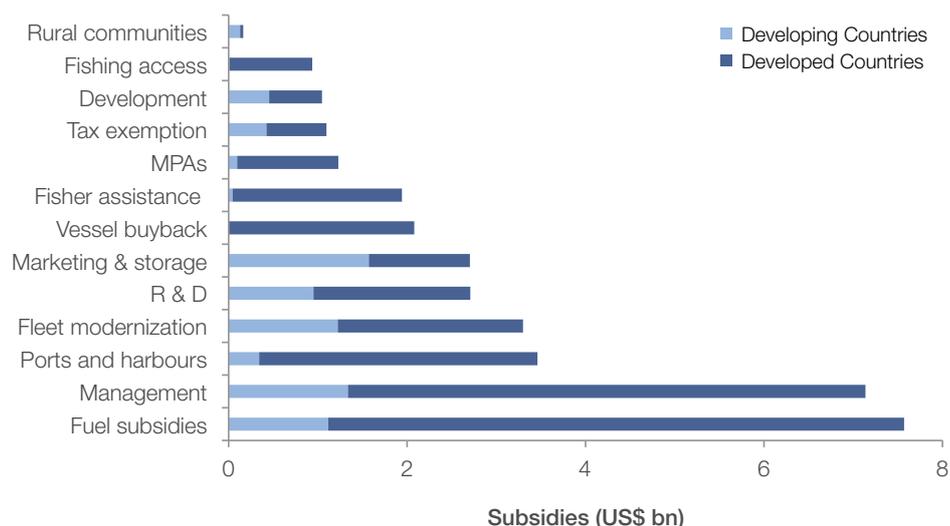
Unilateral trade measures limiting imports of IUU fish have been successful in reducing the profitability of illegal fishing and in requiring transparency of supply chains (a fact welcomed especially by some Small Island Developing States). While it is important that trade sanctions be severe enough to deter illegal activity, it is equally important that they be designed and implemented not to affect legitimate activities (Young 2015). It is also imperative that unilateral measures are based on engagement with exporting countries, including through the provision of technical assistance to enhance fisheries monitoring, control and surveillance. In the case of the EU measure, trade bans are implemented as the last step in a sequence of less trade-restrictive measures and the measure appears to have been designed to be fair, transparent and non-discriminatory. There has been a sense, however, that while bans have been imposed countrywide on small supplier nations, transgressions by larger, more complex and opaque supplier markets may have been unaddressed. This risks making small developing countries suspicious of an otherwise good policy.

We consider below unilateral options both in light of the urgency of the IUU challenge and because they are more feasible in the short term than a multilateral deal. They are also potentially of high impact. Unilateral measures, however, represent second-best options compared with international cooperative actions. By definition they are only as successful as the extent of their enforcement and the size of the market that adopts them. There is thus significant scope for regional, plurilateral and multilateral efforts to address IUU fishing through trade-related measures. Unilateral measures that are anchored in multilaterally agreed frameworks and principles would be particularly useful as stepping stones towards more collective approaches. Moving from unilateral to collective approaches would be helped by an international discussion on what these frameworks, principles, and technical building blocks could be.

<sup>3</sup> The West African sub-region has been identified as an IUU fishing area (38% of catches are estimated to be IUU). The AU-IBAR and NEPAD Policy Framework and Reform Strategy endorsed by African Heads of States and Governments is a good platform to combat IUU in Africa.

<sup>4</sup> According to the Africa Progress Panel (2014) IUU fishing results in losses of around US\$1 billion annually in Sub-Saharan Africa.

**Figure 4: Subsidies by Type and by Developed and Developing Country (2009)**



Source: Sumaila et al. 2013

## 2.4. Fisheries Subsidies

A subsidy is generally understood to be some type of government support to a given private sector of activity, in this case wild fisheries and aquaculture. There are currently hardly any studies on the level of government subsidies provided to the *aquaculture sector* globally. One possible indication of the incidence of subsidies to aquaculture is the fact that aquaculture products figure prominently in anti-dumping cases involving seafood and there is a subsidy element in many of the complaints (Asche 2015). There is thus a general lack of knowledge about the nature and scope of subsidies to the aquaculture sector that needs to be filled to support the appropriate design of trade-related policy options for the sector.

In contrast, studies about the nature and scope of subsidies to the *wild fish sector* abound and they have dominated discussions on this subject over the years (e.g., Milazzo 1998). Despite the many attempts made at estimating the levels of fishing subsidies, measurement and political difficulties mean that reliable and accurate data remains patchy. Improving transparency and finding common definitions of what a subsidy includes would help to inform reform efforts and should be a priority policy issue.

Different kinds of subsidies have different effects on the fish stocks targeted by the subsidized industry. Sumaila et al. (2013) identify three different types of subsidies according to the impact they tend to have on fisheries resources: (i) subsidies for management, research, etc., sometimes defined as good subsidies because they are generally assumed to have a positive effect on our ability to sustainably manage fishery resources; (ii) capacity-enhancing subsidies, including those for boat construction, renewal and some forms of modernization, fuel subsidies,

and fishery development programmes, tend to promote disinvestment in the resource by motivating overcapacity and overfishing; and (iii) ambiguous subsidies, including those to vessel buy-back programmes and rural fisher community development, can promote or undermine the sustainability of the fish stock depending on the circumstances.

Total fisheries subsidies were recently estimated at about \$35 billion a year (Sumaila et al. 2013), which is significant since it constitutes between 30–40% of the landed values generated by wild fisheries worldwide. Of these, capacity-enhancing subsidies make up the highest share, at about \$20 billion in transfers to fishing fleets in 2009, with fuel subsidies constituting as much as 22% of the total (Figure 4). There is evidence that certain subsidies can contribute to the creation of excess fishing capacity, unsustainable levels of fishing effort and overfishing (e.g. Heymans et al. 2011).

This figure shows that fuel subsidies make up the greatest proportion (22% of the total), followed by subsidies for management at 20% and ports and harbours at 10%. Subsidies contributed by developed countries (65% of the total) are far greater than that contributed by developing countries.

It is important to consider the relationship between subsidies and fisheries management. Although the direct impact of subsidies on a fish stock depends on the health of the fish stock and the strength of management in place, fisheries management is very rarely completely effective, and there is also evidence that subsidies can undermine efforts to manage stocks sustainably. This implies that even with good fisheries management subsidies can be harmful (Munro and Sumaila 2002).

<sup>2</sup> India epitomizes this situation with an average MFN applied rate for agricultural products equivalent to less than a third of the bound rate (39.4% vs. 136.1%). But the issue is similar in nature for Mercosur where it equally (and more importantly) concerns non-agricultural products.

<sup>3</sup> Brink (2011), for example, found that application of the parameters suggested in the Doha draft Modalities of December 2008 could mean that allowances (after reduction commitments) for overall trade distorting support, including in particular de minimis allowances, might be such that all developing countries taken together could provide 73% of agricultural support in the world.

Members of the WTO agreed in 2001 to negotiate reductions in fish subsidies. But, over a decade later, the negotiations remain characterized by fundamental disagreements over the respective levels of commitments expected from emerging and more advanced economies and over the role of disciplines on subsidies and fisheries management. However, there appears to have been a resurgence of interest in the negotiations in the first half of 2015. Two groups of countries tabled proposals for similar packages of subsidy disciplines (i.e. those that prohibit the provision of subsidies to IUU fishing vessels and to fishing that targets overfished stocks) and (in one proposal) subsidies that support destructive fishing methods.<sup>6</sup> Significantly, a group of WTO members are also negotiating plurilateral disciplines on fisheries subsidies within the Trans-Pacific Partnership (TPP) agreement (NOAA Fisheries 2014).

While we believe that the ideal option is still to reach an ambitious multilateral agreement on subsidies along the lines of the WTO Chair's 2007 text, we present possible avenues toward meaningful outcomes both within the WTO framework and in other fora.<sup>7</sup>

## 2.5. Tariff and Non-Tariff Measures

Seafood, both from the wild and fish farms, is a widely traded food commodity, with Asia, the US and Europe as key markets (Figure 1). The United Nations Convention on the Law of the Sea (UNCLOS), which came into force in 1982, gave coastal and island states sovereign rights over natural resources within 200 nautical miles of water off their coastlines as exclusive economic zones. This new form of rights over the majority of marine fisheries triggered a new regime of trade in access rights (Campling and Havice 2014). It also boosted trade in wild fish and fish products as developed countries, suffering from stagnating fishery production in their own EEZs and of their flagged vessels in historic developing country waters, sought new sources of fish and increasingly relied on imports (Swartz et al. 2010). This largely explains the relatively low levels of tariff protection applied in several developed countries on fish and fish products, compared with other food products, with only a few exceptions in the form of tariff peaks on a limited set of products. At the same time, several countries maintain relatively higher levels of protection on processed fish, often to protect their processing industry and to promote domestic value addition. In developing countries, tariff barriers tend to be slightly higher, owing to the desire to protect local fisheries sectors (Campling 2015).

Even though trade theory suggests that overall the global community would benefit from minimal barriers, from a sustainable development perspective the question of tariff liberalization presents a number of policy tensions.

The first is balancing the interests of those who benefit versus those who may lose if tariffs on fish products are lowered. Given the economic, social and cultural significance of the sector in some countries, many fish-exporting nations are pushing for new tariff liberalization commitments in multilateral and regional negotiations. Removing market access barriers, such as tariff escalations on processed products, could help developing countries expand their participation in international trade, adding value to their exports and generating income and employment. However, several developing countries have been concerned that further trade liberalization may affect the value of trade preferences granted to them through different schemes under the Generalized System of Preferences (GSP). This is particularly the case of Africa, Caribbean and the Pacific (ACP) countries that have traditionally benefited from significant preference margins in the EU market under the Lomé Convention and the successor Cotonou Agreement. By removing tariffs for ACP countries on certain products, while maintaining it for other trading partners, these preferences have facilitated the development of industrial processing plants such as canning factories or loining plants for tuna in countries like Fiji, Ghana, Kenya, Côte d'Ivoire, Madagascar, Mauritius, Papua New Guinea, Senegal, Seychelles, and Solomon Islands (Campling 2008).<sup>8</sup> These preferences have by and large been preserved in the EU market, where import-competing industries, notably in Spain, have ensured that canned tuna is excluded from most EU regional trade agreements (RTAs). For preference-receiving countries, removing tariffs across the board on a most-favoured-nation (MFN) basis would result in the erosion of their preference margin and could affect the competitiveness of their locally based processing industry. The main policy challenge is therefore to help preference-dependent countries adjust to the changing competitive environment.

Another policy tension relates to balancing the increased demand and potential economic gains from liberalization with the need to limit catch levels to ensure the long-term sustainability of fish stocks. From a sustainability perspective, the relationship between tariff liberalization and capture fisheries and aquaculture production is ambiguous. Tariff reduction could lower prices for consumers and increase demand for fish products. In the absence of effective management regimes to ensure that production is

<sup>6</sup> Elements for defining a Post-Bali Work Programme on Remaining Doha Development Agenda Negotiations" Submitted by Barbados on behalf of the ACP Group of States JOB/TNC/46 of 12 March 2015, and "Elements for Effective Disciplines on Fisheries Subsidies in the Post-Bali Work Programme" Submitted by Argentina, Iceland, New Zealand, Norway, Peru, and Uruguay TN/RL/W/258 of 19 June 2015. See also "Rules Negotiations – Transparency" Submitted by the European Union TN/RL/W/260 of 16 July 2015.

<sup>7</sup> The 2007 Chair's text proposed a comprehensive and sophisticated system of disciplines on fisheries subsidies, including a prohibition of several particularly harmful subsidies (including those to fishing vessel construction and fuel), disciplines on subsidies that harmed fish stocks in which other WTO members had an interest, and a graduated system of special and differential treatment for developing country members to continue to provide some kinds of subsidies, in particular to in-shore fishing.

<sup>8</sup> It is worth noting that the story here is a bit more complicated as most EU tuna fleets, for example, fish in waters under the jurisdiction of those countries and some of the processing plants are EU owned.

kept at levels consistent with sustainability objectives, the pressure generated by trade liberalization could contribute to increased fishing, exacerbating the overexploitation of fish stocks. But these effects are likely to vary depending on domestic fisheries management policies, the method of production (for example capture vs. aquaculture), and country-specific social, economic, and political factors. If revenue from additional trade were invested in fisheries management, for example, trade could help support sustainable fisheries development and long-term food security. A further tariff issue in the fisheries sector (to which we return) is the lack of distinction in tariff and trade statistics between fish derived from wild capture and fish produced by aquaculture, which makes it difficult to track trade in products from each source. Also, tropical fish of less commercial significance to principal markets and increasingly niche products do not have species-specific Harmonized System (HS) tariff codes, making it difficult to discern trends in trade data, including intra-regional trade between developing countries.

As tariff barriers to fish products have fallen through successive rounds of regional integration and unilateral liberalization, non-tariff measures are becoming more significant barriers to market access. These measures, which may be public or private, include standards covering food safety, sustainability and the legality of production with corresponding labels. Non-tariff measures are often perceived differently depending on whether one is an importer or exporter of fish. In general, importing countries see these measures as necessary means to protect public health, and there have been cases that seem to support this view. However, from the perspective of exporting countries, non-tariff measures are often seen as a trade barrier.

Eco-labelling is an ever more present non-tariff measure in fisheries trade. As a market-based tool, usually developed by private actors but sometimes (perhaps increasingly) developed by governments, eco-labels make it possible for consumers to select seafood from well-managed fisheries. In theory, this is a useful tool but the implementation can be problematic, as highlighted in some high-profile papers (e.g. Jacquet et al. 2010). There is a need, in particular, to support mutual recognition between national standards systems as well as developing country access to certification and pre-certification systems so that the use of standards and labels can better support a wider range of sustainable fish production. The use of fishery improvement projects (FIPs) would be beneficial in this respect (Sampson et al. 2015).

It is important to acknowledge that some of the policy options listed below rely (to a varying degree) on distinguishing between fish products based on their processes and production methods (PPMs). While some trade measures may be manifest in the final product (such as a prohibition on the import of juveniles, which would be reflected in the size of the fish itself), most of the trade measures relate to PPMs (such as the legality of fishing methods). Whether trade measures may legitimately differentiate between otherwise “like” (i.e. technically identical) products on the basis of PPMs that are not reflected in the product’s final characteristics has historically been contentious in trade law. However, early GATT panel views on this topic have been superseded by case law at the WTO Appellate Body, which recognizes that distinctions based on PPMs may validly be made (Cosbey and Mavroidis 2014). Trade measures that differentiate on the basis of PPMs may be permissible under WTO rules provided they are designed and implemented appropriately (Young 2015). In the context of sustainable development objectives, the manner in which fish products have been produced does matter, and the policy options have been crafted with the recognition that differentiation based on PPMs may be legitimate as well as legally grounded.

# 3. Trade-Related Policy Options

## 3.1. Prerequisites for Trade-Related Measures to Succeed

We focus on how trade measures related to the issues of subsidies, IUU fishing, and barriers to trade (both tariff and non-tariff) for wild and farmed fish could be implemented to promote the sustainable use of ocean resources. To increase the likelihood of success of these trade-related measures, it is important to take an inclusive, transparent, and coherent approach to addressing the identified challenges. Both public and private rule-making are likely to accelerate, and interdisciplinary approaches are crucial, with the private sector involved. Where existing non-trade-related instruments are already in place, the trade measures proposed would serve to complement rather than replace them. In fact, even though trade-related measures can help address the challenge of sustainable oceans and fisheries use, they have to be part of coherent policy frameworks, which include improvements to the management and governance of fisheries resources at all levels.

### 3.1.1. Inclusiveness

There is only one ocean. Fish do not respect national boundaries as they swim and fish trade, by nature, involves more than one country. Hence sustainable development and long-term use of ocean resources is a global concern. This implies that to employ trade-related measures in support of healthy oceans and sustainable fish and fisheries, international collaboration that is fair and inclusive is needed. In some cases, regional approaches to monitoring and enforcement may be appropriate. In others, the economics and politics of an issue like subsidies may mean that a coalition of countries willing to work on trade-related measures is necessary to create critical mass.

Cooperation with non-state actors (including fishing companies and NGOs), many of which are already working on some of these issues, is paramount—not only to ensure initiatives are well-grounded in the industry’s reality but also for political reasons, as governments, left to their own devices, are unlikely to implement policies that are unpopular in the short term. Greater attention is warranted on the obligations of investors in the fishing industry, fish product suppliers and other private actors. However, it is also important to note that there are different kinds of barriers to cooperation between states and between private actors, including the pursuit of comparative advantage, which might involve free-riding on the efforts of other states to reduce trade in IUU fish or reform subsidies. Barriers to cooperation between private actors can include capacity, transaction costs, and even anti-trust law.

Trade-related measures themselves should be designed to be inclusive. They should be based on generally agreed principles, whether these are defined multilaterally in the FAO or other treaty bodies such as the Convention on International Trade and Endangered Species (CITES), or regionally in regional fisheries management forums (e.g. the Convention for the Conservation of Antarctic Marine Living Resources), or in negotiations on regional and plurilateral trade and investment agreements such as the newly proposed African Tripartite Free Trade Area (TFTA) and the TPP. Ensuring participation of all relevant states will result in trade measures that are fairer, more transparent and non-discriminatory, and that will not create unnecessary obstacles to trade in both their design and implementation. Indeed, current “unilateral” attempts to use trade-related measures to address IUU fishing, such as the EU Regulation on IUU Fishing (EU 2008), are distinctive in their efforts to work collaboratively with affected states and stakeholders. It is also essential to include private actors in these endeavours. Importantly, recent work has made explicit the links between IUU fishing and poor social standards on boats (EJF 2014).

More generally, awareness of the issues, challenges and opportunities related to ocean and fisheries among the general public, stakeholders, and policy-makers is indispensable for the success of any trade-related measure. This broad awareness could translate into support for policy-makers to create the environment that would enable trade-related policies to work towards sustainable oceans and fisheries.

### 3.1.2. Transparency

To achieve international collaboration and joint action, the availability of good quality information is fundamental both in the design of initiatives and in their implementation. It is, therefore, crucial that there is transparency in information, as far as possible, on the types and magnitudes of subsidies provided by countries to their fishing sector and the extent of illegal fishing among all parties. Special effort is needed to improve transparency with respect to fisheries by bringing private sector and public information together in integrated data platforms. This is a difficult and yet important basic requirement for the successful implementation of trade-related measures.

Transparency underpins the recommendations below on IUU import measures, subsidies, and trade data. Meaningful transparency relies on up-to-date and reliable data on fish catch, the broader health of fisheries and the economics of the industry. Improving the collection and sharing of

this data is an essential prerequisite for efforts, both public and private, to support sustainable fisheries. It is a stand-alone cross-cutting policy recommendation, and we outline specific options for how different types of data could be sourced and shared.

It is important to take into account the reasons transparency might not be achieved easily if forward momentum is to be realized. For governments, resistance to transparency could reflect both the tremendous cost of collecting and updating reliable data as well as a desire to avoid self-incrimination regarding potentially damaging policies in place (or absent) concerning subsidization or IUU fishing. Resistance to transparency initiatives on the part of private actors could reflect both the cost of collecting data and, at least in part, a desire to protect commercial in-confidence business information. A key to addressing the wariness of fish traders with respect to supply chain transparency is to enable information about how, where and by whom fish are caught to move along the supply chain without revealing commercial intelligence on the roles played by different actors.

### 3.1.3. Policy coherence

Coherence is necessary because many of the issues to be grappled with are interconnected. Addressing the challenges of sustainable oceans and fisheries goes beyond trade policy, which is but one (albeit important) component of the coherent policy framework required. Relevant examples include: (i) the importance of underlying management regimes, both national and international (through multilateral environmental agreements (MEAs) and RFMOs), on which trade measures are often based, in managing access to fisheries resources; and (ii) the importance of social policies to ensure the socio-economics of the fishery are also sustainable. Hence, in developing trade-related policies in general, it is important to take a holistic view of the problems and policy options proposed to resolve them. Addressing issues at the intersection of healthy oceans, sustainable fisheries and the trade system requires a comprehensive approach that takes into account ecological, economic, and legal realities as well as existing multilevel governance regimes. In addition to designing measures that take account of these complexities, implementation must be sensitive to local realities in relevant communities.

The rest of this section outlines three “work packages” of policy options that could help address the challenges identified above. The policy options recommended under each work package are structured and developed through the identification of the following elements: (i) current status; (ii) gaps to be filled; (iii) steps to be taken; and (iv) parties that need to lead and be involved for implementation. A time horizon is presented in conclusion.

## 3.2. Work Package 1: Market Access Conditions to Prevent, Deter and Eliminate IUU Fishing

The goal is to suggest trade-related policy measures as critical elements of a solution to the ocean and fisheries problem, which, at its roots, is caused by overcapacity in fishing fleets, inadequate fisheries management, weak governance and greed. This goal could be achieved by progressively closing down international trade in IUU fish products, taking into account the implications of adjustment for low-income countries. People engage in IUU fishing mainly because it pays economically. And it pays because there is a market for illegally caught fish. One way to eliminate IUU fishing is to develop means to make it difficult for fish products from IUU fishing to enter the market.

### 3.2.1. Policy Option 1: Build consultative, effective and coordinated unilateral import measures

While the ideal policy option is probably a multilateral agreement, this work package includes options for unilateral measures that could have an impact in the short to medium term, and, if well designed, could act as stepping stones towards a multilateral solution.

Trade-related efforts to address IUU fishing before 2010 focused on the use of national laws to enforce multilateral rules. Some international instruments in regional fisheries management organizations and the FAO’s International Plan of Action (IPOA) on IUU fishing (FAO 2001) contemplated the use of unilateral measures, albeit with a strong preference for multilateral solutions. The European Union’s IUU regulation and the FAO’s Port State Measures Agreement (PSMA) marked an important evolution in approach. The EU’s system of import requirements and particularly its escalating warning system have had a big impact. A good example of the effect of EU unilateral measures is Ghana. After the country received a yellow card under the EU’s IUU regulations in November 2013, the country used this as an opportunity to improve the monitoring of its waters. Thailand has also recently implemented a new policy to tackle IUU fishing by its vessels in order to avoid being subject to a red card by the EU. The US approach, set out in the Action Plan of the US Presidential Task Force on Combating IUU Fishing and Seafood Fraud (NOAA 2014), will likely rely on more direct information requirements concerning a set of species at risk and facilitated access for “trusted traders” who meet the verification requirements. In both the EU and emerging US systems, tensions between transparency and traceability, as well as sovereignty and commercial confidentiality are among the critical issues.

A key gap in the current situation is that the EU’s import policy is limited to one import market. Other major markets for fish products do not have similar systems—although the US, as indicated, is currently developing options. To make progress, other large seafood markets, particularly the US and Japan, could adopt transparent and consultative trade measures that incorporate good aspects of the EU system, such as those that address IUU fish transshipment and imports, including a ban as a last resort.

Domestic legislation would be required to make this recommendation work. Coordinated unilateral measures must include consultation with affected trading partners, and should take a stepwise approach with an import ban as the last step. Even though this action could violate WTO rules on quantitative restrictions or national treatment, it could also be justified under the exceptions in GATT Article XX if care is taken in designing and implementing the measure so that it is not discriminatory or excessively trade-restrictive.<sup>9</sup> The measures could also be based on international standards, such as the catch certification guidelines currently under discussion at the FAO, which could enhance their consistency with the Agreement on Technical Barriers to Trade (TBT). Moreover, unilateral technical regulations may meet the requirements of the TBT Agreement if they seek to meet a legitimate regulatory purpose and if they do not create unnecessary obstacles to trade.

As a complement to unilateral measures to address imports of IUU caught fish, countries could implement policies that prosecute domestic importers who violate trade measures. A good example is the US Lacey Act, which stipulates that it is unlawful to trade in specimens taken, harvested, transported, sold or exported in violation of underlying laws in a foreign country or in the US. This type of legislation can draw on CITES provisions which stipulate that penalties are shared between the country of import and that where the violation occurs.

A second gap relates to the fact that the effectiveness of EU member states in implementing the import measures is unclear (Palin et al. 2013). Countries implementing unilateral measures should strive to continuously improve them, including by monitoring and providing strong (positive and negative) incentives for compliance by their own nationals. It should be noted that any successful IUU import measure will depend on fisheries management tools, including Catch Documentation Schemes, IUU vessel lists, traceability, and flag state responsibilities. The real impact of an IUU measure will depend on improving the reliability of these underlying marine governance systems.

The effective implementation of unilateral measures in large import markets requires leadership by the relevant countries (such as the US, EU members, China and Japan), civil society as well as domestic fishing and processing industries. There is also scope for private sector agreements to contribute to this effort, including those taken at regional and multilateral levels. Critically, unilateral measures need to take into account the impact of the required shift in production on producers in low-income countries and attend to the issue. For example, Aid for Trade (Aft) or other assistance measures could be used to help producers meet traceability requirements for example.

### 3.2.2. Policy Option 2: Create a network of regional measures to address IUU fish trade

Unilateral measures, even when implemented by very large markets, are effective only to the extent that producers cannot send their products elsewhere. The global nature of fisheries trade means that many producers may be able to sell IUU caught fish in less regulated markets. One way of extending the reach of import measures is to adopt them on a bilateral or regional basis through regional trade agreements. The real novelty in this approach is that it seeks to use regional trade agreements to link unilateral IUU trade measures together, either directly or by establishing platforms that will help countries converge towards best practice.

The EU's import measure is currently the strongest option being implemented. The TPP agreement may provide another example, but it appears likely to impose relatively soft obligations on its parties when it comes to addressing IUU fish trade. A shortcoming of the existing EU import measure and the future system to be applied in the TPP (an agreement that will include large fish markets like the US and Japan) is that they are not linked in any way, thereby creating the potential for inconsistency. Moreover, the membership of these regional agreements currently excludes some large import markets, such as China. Plugging this gap would make these measures more effective.

To address this gap, regional trade agreements could be used to build a cohesive network of regional platforms for IUU measures in several ways: (i) the Transatlantic Trade and Investment Partnership (TTIP) could include provisions to ensure coherence between the EU IUU system and the evolving US system; (ii) the TPP could establish a platform for parties to the agreement to move towards current best practice in import measures (the EU system) or move towards a linked US-EU import system if and when developed; (iii) the recently proposed African TFTA, which aims to bring together three of the continent's large Regional Economic Communities (RECs) in a grand free trade agreement, could be used as a platform for dealing with trade in IUU products; and (iv) other large import markets could join the TPP or TFTA IUU platforms, either through accession to the TPP (with market access as the incentive) or through separate adherence to the provisions of the agreement establishing the IUU platform (with political kudos and normative leadership as the incentive).

For progress to be made, the EU and US would need to negotiate and approve relevant provisions in the TTIP. In addition, other large markets would be key to expanding the coverage of the TPP platform. The African TFTA, if used as a platform, would need to expand to cover other RECs—e.g. the Economic Commission of West African States (ECOWAS).

### 3.2.3. Policy Option 3: Develop a system of multilateral instruments on trade in IUU fish products

Regional approaches to closing the market for products from IUU fishing could gradually help change the economics of the activity such that the cost of supplying IUU fish is too high to make it worthwhile on a large scale. However, a comprehensive and inclusive solution to the problem would most efficiently be negotiated multilaterally—hence the call for a system of multilateral instruments. This idea is new in the sense that it seeks to use regional trade agreements to support the entry into force of other multilateral instruments and in that it seeks to establish, through the WTO, a code of conduct on illegal trade, which does not appear to have been done before.

Currently, IUU fish trade is addressed in some existing multilateral instruments but not in the trade system itself. An example is the FAO's Port State Measures Agreement (PSMA) targeting the landing of illegal fish products, which is yet to come into force because only 11 countries have ratified the agreement to date. CITES is another good example. Even though CITES has been used to protect several important and vulnerable species, many marine fish species, particularly bluefin tuna, are not subject to protection.

To make progress in implementing a multilateral approach to trade in IUU fish, the following options could be considered. RTAs could be used to incentivize ratification and eventual entry into force of the PSMA. For example, parties to the TPP or the TFTA could agree to ratify the PSMA and make PSMA ratification a requirement for accession to these agreements. Second, key endangered fish species (e.g. bluefin tuna) should be listed in Appendix I or II of CITES, with support for industry adjustment in countries affected by the resulting trade restriction. Third, a multilateral agreement focused on trade in IUU fishing products could be developed. Key elements of best practice from unilateral or regional IUU systems could be captured in a voluntary code on IUU fish imports and transshipment within the WTO. Finally, it is important to stress the importance of RFMOs in developing effective solutions.<sup>10</sup>

The key institutions that can assist in the implementation of these policy options are the FAO, RFMOs, CITES, and the WTO. The contracting parties to CITES would need to agree to the listing of more vulnerable marine species. Also, WTO members participating in unilateral or regional IUU schemes could lead the development of a voluntary code within the WTO.

### 3.2.4. Policy Option 4: Support the expansion of private sector schemes

It is generally accepted that state-based solutions alone will not be sufficient to address the challenges of IUU fishing. They need to be supported and complemented by private sector initiatives and actors.<sup>11</sup> Several private sector certification schemes either include or focus on assessments of the sustainability and legality of fish caught. Some of these schemes already involve comprehensive and reliable traceability systems, which could also be used to ensure the legality of the provenance of fish in the supply chain. The limitations of existing schemes include: (i) many fisheries, particularly those in developing countries, are not covered by private sector certification or other schemes; (ii) the traceability of fish products, especially in low-capital fisheries, is very difficult; and (iii) the mislabelling of fish products is common.

Enhancing the participation of developing country fisheries in sustainability certification involves both simplifying access to certification systems (e.g. through group certification under the Global Aquaculture Alliance) and providing less rigorous options, such as fishery improvement projects, which are upgrading processes rather than consumer-facing standards. The sequencing of improvements is key to ensuring cost burdens are manageable.

To improve private sector schemes, certification bodies could require evidence that the catch is both from a sustainable fishery and that it is legal. Certification bodies could also work to ease the accessibility of their schemes to developing country fisheries. Assistance could come in the form of increased AfT support for the development of data collection, which would serve both private and public sector initiatives, and the development of infrastructure to enable the traceability and eventual certification of fish products. For implementation to be successful, all parties (i.e. public and private certification bodies, fish buyers, and the fishing industry) would need to be involved in the process. Private and public fisheries legality and sustainability certification bodies, along with AfT donor and recipient governments, would need to take the lead in implementing this policy option.

<sup>10</sup> Roheim and Sutinen (2006) provide a useful discussion on how multilateral environmental agreements have important implications for the effectiveness of RFMOs.

<sup>11</sup> A good example of how private and state actors can work together to deal with IUU fishing in the Southern Ocean is described in Österblom et al. (2015).

### 3.3. Work Package 2: Disciplining Fisheries Subsidies

The goal of this work package is to improve transparency around global fisheries subsidies and build momentum towards a multilateral agreement on subsidy reform.

#### 3.3.1. Policy Option 5: Developing reliable data on fisheries subsidies

Improving transparency around fisheries subsidies is a fundamental requirement for further work on disciplines. Greater transparency could stimulate action not only by revealing the scale of the problem, but also by providing a solid dataset accepted by governments with the responsibility of implementing reform. A solid database would provide a basis for measurement by both governments and civil society of subsidy reductions or increases. This would underpin the transparency and monitoring of unilateral reform efforts, support improved coherence across national policies, strengthen momentum for collective reform, and enable the implementation of reduction commitments to be verified. More broadly, there is a need for greater awareness of the impact of subsidies provided by trading partners and of how regional approaches to reform could be developed based on national practices and priorities.

Currently, WTO members are obliged to notify fisheries subsidies under the Agreement on Subsidies and Countervailing (ASCM) Measures. Parties to the TPP are also likely to be subject to an additional obligation to notify their fisheries subsidies. The OECD and others maintain databases of notified and estimated subsidy levels while the G20 receives reports on certain subsidies from different intergovernmental organizations (IGOs). Yet, notification of fisheries subsidies remains patchy despite the obligation in the WTO. There are few independent assessments of actual subsidy levels against which to evaluate notifications and the actual consequences of not fully notifying are minor. Independent databases and reports produced by IGOs, NGOs and academic sources are helpful but their coverage of countries is limited and in some cases must rely on estimates.

Further support for the development of comprehensive and independent databases of fisheries subsidies (similar to the OECD's work on agricultural and fossil fuel subsidies) is thus needed. These databases could be used by NGOs, academic institutions and other civil society groups to publish independent analysis. They could also inform the counter-notification of fisheries subsidies by WTO members. The WTO Secretariat could reference counter-notifications by governments and/or parallel independent research by IGOs or NGOs in Trade Policy Reviews (which serve as fora for discussion). Committees in RTAs could also reference counter-notifications by governments or information from NGOs in their reviews of member notifications. Specific additional notification requirements for fisheries subsidies could be established in the WTO, possibly by linking them to new fisheries subsidy disciplines.

The academic, IGO and NGO communities would need to serve as agents of change by providing ongoing independent research and assessment work on fisheries subsidies. WTO members would need to file the proposed counter-notifications by relying partly on this research. Finally, RTA members would need to provide leadership in the relevant RTA committees that review subsidies, also with the help of this independent research. In terms of further research, there is a general lack of knowledge about subsidies to the aquaculture sector. Work is needed to fill this gap so as to inform the design of appropriate measures.

#### 3.3.2. Policy Option 6: Core group of countries adopts fisheries subsidies disciplines

It is worth repeating that the ideal option for fisheries subsidies disciplines is still to agree to an ambitious multilateral agreement along the lines of the WTO Chair's 2007 text. However, given the difficulty in achieving universal subsidies disciplines through the WTO and the urgent need to take action to tackle the problems of oceans and fisheries, a possible approach would be for a group of countries, possibly in partnership with IGOs, to move forward with disciplines. The key limitation of the plurilateral approach, as exemplified by the TPP, is that many large subsidizers (e.g. China, Chinese Taipei and Russia) are not part of the current group of negotiating parties and any agreement reached would therefore not be applicable to them. To reduce the extent of free-riding, an agreement among a core group of countries to reform harmful subsidies could, in the context of an RTA, be combined with trade rules that specify preferential conditions under which this group of countries would engage in the trade of fish and fish products with countries that are not participating in the agreement. Outside the framework of an RTA, the incentives to join a subsidy reduction initiative (beyond the purely political) may be limited.

The kind of core group envisaged above could be built through one or more of the following options: (i) accession to an existing RTA would require acceptance of the RTA subsidies disciplines in exchange for preferential market access; (ii) RTA disciplines could also become a stand-alone code that large subsidizers would have political incentives to join; (iii) the US could push to introduce TPP disciplines into the TTIP, thus extending them to the EU; and (iv) other regional agreements (e.g. ASEAN, the Pacific Alliance, CARICOM, ECOWAS) could also adopt disciplines on a regional basis (e.g. Österblom et al. 2015). Regional groupings could also agree to lock in domestic subsidy reform efforts through provisions in their agreements.

For progress to be made in bringing this policy option to fruition, parties to RTAs, such as the TPP, ECOWAS, the African TFTA and TTIP, would need to push the agenda for inclusion in relevant agreements with the support of NGOs. Governments that are parties to regional agreements would need to back the proposal while the support of local civil society would be crucial. Regional groupings could also agree to lock in domestic subsidy reform efforts through provisions in their agreements.

### 3.3.3. Policy Option 7: Establish multilateral disciplines built stepwise and bottom-up

Another possible approach would be for a group of countries, perhaps in partnership with intergovernmental organizations, to stimulate collective action with bottom-up voluntary commitments to subsidy reform. Through a process similar to the approach taken in climate change negotiations, each country would declare the amount of capacity-enhancing subsidies that they would voluntarily eliminate within a given time period. Based on these voluntary commitments, the group would then negotiate the remaining “ambition gap” between the offers made and the level of overall reductions required at a multilateral level. This kind of initiative can in and of itself stimulate other countries to follow the example of this group. To effectively close the ambition gap between the voluntary offers and the desired level of global reductions, this approach would require either multilateral participation or at least the involvement of the world’s largest providers of fisheries subsidies.

Civil society groups could help accelerate the uptake of this example by encouraging and prodding countries. To further catalyse action, countries could explore the development of creative incentives to encourage others to join such an initiative. Again, this recommendation would have to be implemented in accordance with existing international agreements such as CITES and the WTO.

The stepping stone of a plurilateral agreement could eventually be multilateralized in the WTO if enough large subsidizers were involved. There are several options for this, including: (i) RTA parties (and members of a wider core group) would recommit in the WTO to agreed subsidy disciplines in the form of a voluntary code or binding agreement to reduce subsidies, the benefits of which would apply to all other countries on an MFN basis (like the Information Technology Agreement); (ii) the core group would then negotiate their own phase-out of the remaining important subsidies in the ambition gap—e.g. subsidies to fuel and vessel construction; and (iii) accession by other WTO members to the WTO agreement (or code) would require adherence to the basic disciplines agreed by the core group and a commitment to phasing-out the gap subsidies. It is possible that work underway on fossil fuel subsidy reform could result in useful spillovers regarding fuel subsidies to fisheries.

The leadership of relevant RTA members and a wider core group of major subsidizers would be needed to bring this option to life in the WTO.

### 3.3.4. Policy Option 8: Restart WTO negotiations based on areas of agreement

The first best option—an ambitious multilateral agreement—could be pursued by restarting the WTO negotiations by focusing on areas of relative agreement. As noted in section 2.4 *supra*, proposals for a small package of subsidy disciplines tabled early in 2015 suggest that there is still interest in achieving multilateral disciplines.

As identified in the WTO Chair’s 2011 report on the fisheries subsidy negotiations, areas of (relatively) more agreement include subsidies to IUU fishing, vessel transfers and access agreements. There was arguably some level of agreement, at least in principle, with the idea of reforming vessel construction subsidies and those affecting overfished stocks.<sup>12</sup> It may therefore be possible for countries to agree to eliminate a small list of subsidies in the interest of healthy oceans and sustainable fisheries by focusing on the low hanging fruit—i.e. subsidies whose reform attracted the most support in the WTO negotiations.

Another option would be to restart the WTO negotiations focusing on the capacity- or effort-enhancing subsidies that evidence suggests are most likely to be harmful (e.g. construction, fuel) and concentrate on developing instruments to phase them out within a fixed time frame. Leadership in implementing this policy option would come from WTO members with support from the scientific community on the evidence of harm.

### 3.3.5. Policy Option 9: Align incentives by focusing subsidy negotiations on international fish stocks

A key reason for the lack of progress in protracted subsidies negotiations at the WTO is that the negotiations suffer from what has been described as the “lumpiness” problem (Sumaila 2013). This refers to the requirement that WTO negotiators should aim for an all-inclusive deal or no deal at all. This has limited the ability of the WTO fisheries subsidies negotiations to make progress by confounding the subsidies issue with other problems. One way to overcome this difficulty is to align subsidies policies with national interests by splitting the world’s fisheries into domestic and international fisheries.<sup>13</sup> International negotiations could then prioritize agreement to reform subsidies that affect international fish stocks, and governments would work unilaterally to reform subsidies that affect their domestic fisheries. This policy option may not be that far-fetched because a close look at the work of RFMOs reveals that their operating framework is at least partly based on this approach.

<sup>12</sup> The FAO estimates that 29% of stocks are overfished.

<sup>13</sup> The former would comprise fisheries operating within a country’s EEZ targeting fish stocks that spend all their lives within the EEZ. The latter would include fish stocks that are transboundary or highly migratory, such as tunas that straddle the EEZs of countries and the high seas, or discrete high seas stocks that spend all their lives in the high seas.

A key impediment in moving this proposal forward is that there appears to be limited political incentive to address subsidies to domestic fisheries. This may be due to inadequate and insufficiently widespread knowledge among the public and policy-makers of the negative impact of subsidies that encourage overfishing. That is why transparency is an integral component of the subsidies discipline debate.

Analysis that helps identify international and shared fish stocks as opposed to domestic ones is necessary to instigate this recommendation. Work in this area has already begun (Teh and Sumaila 2015). The following steps would be needed to implement the option: (i) restarting the WTO negotiations with a higher priority assigned to subsidies that affect international stocks (discrete high seas, shared, straddling, highly migratory) and then expanding the disciplines to EEZ subsidies; (ii) building evidence around the impact of domestic subsidies on domestic fish stocks in key countries; and (iii) lobbying for reform of domestic fishing subsidies. Key drivers would include domestic civil society actors, national governments, relevant bodies in RTAs, the research community, NGOs and WTO members, with support from the FAO.

### 3.4. Work Package 3: Tariff and Non-Tariff Measures

While in the IUU and subsidies work packages the objective is to ensure that trade does not undermine the environment, the main aim of this work package is to ensure that international markets function effectively and that they enable developing country producers to move up the value chain. There are several broad policy reforms that could support more efficient markets for fishery products. These include reducing distortions like tariff escalation, improving trade infrastructure and establishing procedures to lessen the costs of trade.

The policy options outlined below address more specific issues in international fisheries trade. Given the heterogeneous nature of fisheries production and its ecological and economic variables, governments will need to work case-by-case to ensure that they integrate the impact of tariff liberalization on relevant production and trade flows in a sustainable manner.

#### 3.4.1. Policy Option 10: Differentiate between capture and aquaculture fish in HS tariff codes

Distinguishing between wild-caught and aquaculture fish products in tariff lines would enable better measurement of the changing structure of global fisheries trade and improve the traceability of products through the value chain. It would also help policy-makers address the distinct environmental impacts of the two production methods. Moreover, further differentiation could be added to HS tariff codes to distinguish among inland freshwater capture fishery products as well as within aquaculture depending on methods of production. The purpose of this differentiation would be to gather information regarding capture and aquaculture product flows, and not to allocate distinctive tariff levels to different kinds of product. However, it is clear that once differentiation is possible, political pressures may emerge to apply different levels to the two tariff lines.

A proposal to distinguish wild caught and aquaculture product is currently being considered in the World Customs Organization (WCO), but actual implementation is pending a final decision. Governments around the world would have to support this policy for it to be implemented and national customs authorities would play a major role.

#### 3.4.2. Policy Option 11: Support the adaptation of preference-dependent countries

As preference margins are gradually eroded, preference-dependent producers will need to adjust to the changing competitive environment. More flexible rules of origin (ROO) for preferential market access could help these producers diversify their sourcing of inputs and access global production networks, thereby creating more options as their competitiveness evolves. Evidence from Papua New Guinea suggests that negotiating more flexible rules of origin under preference schemes and RTAs is a useful adjustment mechanism for preference-dependent producers to deal with falling preference margins (Hamilton et al. 2012).

Few preference agreements allow for the global sourcing of inputs. Given the growing impact of RTAs on preferences, more flexible ROO arrangements could be negotiated in bilateral or regional agreements. More flexible rules regarding cumulation could also support the development of regional value chains. Greater flexibility in preferential arrangements could be conditioned on fish meeting sustainability and legality requirements. However, given the potential domestic distributional impacts of these changes on the benefits derived by fishing interests from preference allocating states (e.g. the EU), there may be considerable opposition to greater flexibility. The key actors that can influence the implementation of this policy option are countries that allocate and receive preferences. Beyond rules of origin, there may be a case for international financing mechanisms, including under the AfT initiative, to provide technical assistance for producers to adjust to reduced competitiveness caused by preference erosion or graduation from preference schemes.

#### 3.4.3. Policy Option 12: Provide assistance to low-income fish exporting countries to reach standards

The aim of this option is to help producers adapt to changing competitive conditions imposed by sustainability standards. As tariff barriers become less relevant in major markets due to the growing network of RTAs, public and private standards are likely to become the main market access constraint for fish products. Producers that are small, located in poor countries, with limited access to capital, or operating in fragmented industries are at a disadvantage when it comes to meeting public and private standards in export markets. Given the contribution of fisheries trade to employment and income in developing countries, an inclusive approach in which producers can move towards certification is essential.

Financial, technical and institutional support from home governments, donors and (where appropriate) lead firms (e.g. branders and retailers) is necessary to spread the costs required to comply with standards. Partnerships between

fish exporting least developed country (LDC) producers and environmental organizations may also be a good option to explore. Aid for Trade, the International Trade Centre and bilateral donors could provide technical assistance to help exporters, especially LDCs, meet these standards. Importing countries could further reorient AfT disbursements or tariff revenues to support this policy option.

The private sector, which has been at the forefront of much work on sustainability standards, has an important leadership role in this recommendation. Private actors are well positioned to both improve access to existing certification schemes (as the Marine Stewardship Council is doing) and assist producers and retailers to work towards bridging the gap between production realities and sourcing requirements (as conducted, for example, in FIPs).

#### 3.4.4. Policy Option 13: Ensure coherence between private standards and the TBT Code of Good Practice on standards

Standards and technical regulations (including labelling) established by WTO members are subject to the provisions of the SPS and TBT Agreements. Private standardization and labelling schemes or other commitments on the part of private actors and investors in the fishing industry should contribute to the overall effort toward healthy oceans and sustainable fisheries and aquaculture production over time. An endeavour is already underway within the fisheries industry to reduce unnecessary duplication in certification schemes.

Although the provisions of the TBT and SPS Agreements do not formally cover private standards and labels, non-governmental standard-setting bodies should be urged to adhere to the TBT Agreement's Code of Good Practice for the Preparation, Adoption and Application of Standards. In order to harness both their economic power to shape production patterns and ensure they are inclusive, these schemes could be encouraged to follow some of the basic principles set out in the 2000 Decision of the TBT Committee on international standards, such as transparency, openness and coherence, while preserving their effectiveness as incentives for sustainable production.

Multilateral standards platforms, like those run by the United Nations Forum on Sustainability Standards (UNFSS) and the ITC, could focus on sharing information and, where relevant, providing technical assistance to meet fisheries product standards. Leadership for pushing this proposal forward would have to come from private sector standard-setting and certification bodies. The UNFSS and ITC Secretariats would also have an important role.

#### 3.4.5. Policy Option 14: Link mutual recognition systems for standards applicable to fish products

National SPS and TBT systems differ and are sometimes applied inconsistently. This creates uncertainty in the policy environment. Several of the mega-regional trade agreements currently under negotiation, in particular the TTIP and TPP, are likely to be significant both in terms of size and depth. Together, these agreements will not only lower market access barriers but also establish new rules covering behind-the-border measures affecting over half of world trade. While they are unlikely to seek to harmonize technical regulations and standards, they may establish mutual recognition for some testing and conformity assessment processes.

Mutual recognition between large markets can exclude other producers and reduce their competitiveness—even when standards can be met. In order to ensure that these integration tools are inclusive, the parties to large RTAs could consider including a linking mechanism by which trading partners who are outside of the agreement, but whose systems enjoy mutual recognition with one or more of the parties involved, could benefit from the agreement's wider mutual recognition provisions. In other words, large RTA mutual recognition frameworks should allow non-parties to gain recognition and market access for their products provided their testing systems are certified as meeting the required standard by any one of the parties to the RTA. This provision, combined with technical assistance and capacity building to meet recognition requirements, could help change the cost-benefit equation for producers outside of the regional agreements.

This linking provision could be included in the text of the TPP and TTIP, as well as relevant RTAs such as the TFTA, with appropriate support provisions to help key trading partners, particularly LDCs, bring their testing and conformity assessment systems up to a standard at which they could be recognized by the broader system. In terms of leadership, parties to the TPP, TTIP and other RTAs of relevance are well positioned to realize this policy option.

# 4. Priorities and Next Steps

A number of wild fisheries and aquaculture management and governance institutions have been established to support the sustainability of oceans and fisheries. While there are examples of success, the prioritization of short-term gains, the lack of precautionary and ecosystem-based management, and the weakness of enforcement mechanisms have impeded progress towards the sustainable management of fisheries. The erosion of resources continues to undermine the long-term interests of many communities, including food security, employment and income.

Priority trade-based policy solutions include the reform of harmful subsidies and efforts to restrict the global fisheries market to sustainable and legal products. While there is a preference for multilateral approaches, in light of the pressing challenges facing oceans and fisheries worldwide and the need for expedited action, this paper proposes policy options that may compromise on multilateralism in the short term in order to facilitate the building of broader solutions in the system in the longer term. Coordinated unilateral instruments, including trade bans, could be useful short-term measures, but they should be fair, transparent, reasonable and proportionate. In addition, improving transparency by developing comprehensive data on fisheries subsidies would help inform reform efforts and should be a priority policy issue.

A sectoral trade agreement on sustainable fisheries could address a number of different aspects of fisheries trade, including tariff and non-tariff measures, IUU fishing and fisheries subsidies. Aid for Trade and other development finance tools can be used not only to catalyse agreement and action but also to mitigate the potential negative impacts of these policies on small-scale fisheries. Such a sectoral initiative could be developed either within the WTO as a plurilateral agreement or within the framework of regional trade agreements.

## 4.1. Time Scales for Implementation

Table 1 provides an indicative time scale for implementing the policy options under the three work packages proposed in this paper. Short-term policy options are those that we estimate can be implemented within one to three years; medium and long-term options are estimated to take between three to five and five to ten years respectively. It is expected that medium to long-term policies would likely have bigger impacts in terms of their effect on the sustainability of fisheries. It should be noted, however, that this categorization reflects a combination of positive and normative assessments of what is feasible.

**Table 1: Oceans and Fisheries Policy Options Time Scale**

	<b>Closing the market for IUU fish</b>	<b>Disciplining fisheries subsidies</b>	<b>Tariff and non-tariff measures</b>
<b>Short term</b>	Policy options 1 & 4	Policy options 5 & 6	Policy options 10, 11 & 12
<b>Medium term</b>	Policy option 2	Policy option 8	Policy option 13
<b>Long term</b>	Policy option 3	Policy option 7 & 9	Policy option 14

Under the work package on closing the market for IUU fish catch, options 1 (unilateral measures) and 4 (private sector schemes) would be important in that they could catalyse the global community to implement policy options 2 (regional measures) and 3 (multilateral instruments)—i.e. those options that are more difficult to realize but if successfully implemented would have widespread impacts.

With regards the work package on fisheries subsidies, options 5 (reliable data) and 6 (core group disciplines) would provide both a basis and an impetus for implementing policy options 7 (bottom-up multilateral disciplines), 8 (restarting WTO negotiations) and 9 (aligning incentives around international fish stocks), because reliable data would generate the information needed while action by a core group of countries could spur wider participation in efforts to discipline capacity-enhancing subsidies.

Policy options 10 (tariff code differentiation), 11 (preference-dependent adaptation) and 12 (assistance to reach standards) in the work package on tariff and non-tariff measures seem feasible in the short term. Their implementation would have a significant impact in supporting sustainable trade in fish and fishery products and in stimulating action on options 13 (standards coherence) and 14 (linking mutual recognition systems).

## 4.2. Concluding Remark

The analysis and proposals reported herein can contribute to work currently underway in areas such as multilevel governance in fisheries, the relationship between oceans and climate change mitigation efforts, energy subsidies, the correlation between subsidies and global fishing activities, and the intersection between trade and IUU fishing. The ideas suggested in this paper are also relevant to ongoing work on financial aspects of the fisheries industry, including financing small-scale fisheries, developing investment rules and dealing with money laundering in the fisheries sector. To restate the premise on which this policy option paper has been prepared: with 37% of fish and fish products traded internationally, enlightened and well-informed trade-related policies can make an important contribution towards securing a healthy ocean and sustainable fisheries worldwide. The three work packages provide an innovative and inclusive agenda for domestic reform and international cooperation.

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## Overview Paper and Think Pieces

### E15 Expert Group on Oceans, Fisheries and the Trade System

Asche, Frank. 2015. *Aquaculture: Opportunities and Challenges*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Campling, Liam. 2015. *Tariff Escalation and Preferences in International Fish Production and Trade*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Sumaila, U. Rashid, Christophe Bellmann, and Alice Tipping. 2014. *Fishing for the Future: Trends and Issues in Global Fisheries Trade*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Young, Margaret. 2015. *Trade-Related Measures to Address Illegal, Unreported and Unregulated Fishing*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

The papers commissioned for the E15 Expert Group on Oceans, Fisheries and the Trade System and can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Work Package 1: Market access conditions to prevent, deter and eliminate IUU fishing</b>					
<b>1. Build consultative, effective and coordinated unilateral import measures.</b>	Short term	<p>This is already happening.</p> <p>The EU import measure is currently the strongest option being implemented. While the ideal would be to have a multilateral agreement to address the challenge of IUU fishing, in the meantime, transparent and consultative unilateral trade policy measures are a useful way forward.</p> <p>A US Presidential Task Force has also released an action plan to begin to address the challenge of illegal fish trade.</p>	<p>1) Currently, a key gap in the effectiveness of the EU's measure is that it is limited to one import market; other main markets don't have similar systems.</p> <p>2) Compliance by EU's own member states with the import measures is not always clear.</p> <p>The impact of any IUU measure will depend on improving the reliability of marine governance systems and fisheries management tools, including Catch Documentation Schemes, IUU vessel lists, and flag state responsibilities.</p>	<p>1) Other large seafood markets, particularly the US and Japan, should be encouraged to adopt transparent and consultative trade measures, taking into account current best practice in the form of the EU's system, to address IUU fish transshipment and imports, that include a ban as the last option.</p> <p>2) Those countries implementing unilateral measures should strive to continuously improve them, including by monitoring and providing strong (positive and negative) incentives for compliance by their own nationals.</p>	<p>1) Implementing unilateral measures in other large markets will require leadership by the relevant governments, civil society as well as domestic fishing and processing industries.</p> <p>2) Improving existing unilateral measures will require leadership by governments and the fishing industry.</p>

<p><b>2. Create a network of regional measures to address IUU fish trade.</b></p>	<p>Medium Term</p>	<p>The EU import measure is currently the strongest option being implemented.</p> <p>It is possible that the TPP agreement may impose relatively soft obligations on its parties to address IUU fish trade.</p>	<p>The existing EU import measure and potential system to be applied to TPP parties (including large markets like the US and Japan) do not appear to be linked.</p> <p>The membership of existing regional agreements (RTAs – into which platforms would be built) currently excludes some large import markets (particularly China).</p> <p>The approach in this policy option seeks to use regional trade agreements to link unilateral IUU trade measures together, either directly or by establishing platforms that will help countries converge towards best practice.</p>	<p>Regional trade agreements could be used to build a cohesive network of regional platforms for IUU measures in several ways:</p> <p>1) The US-EU TTIP agreement could include provisions to ensure coherence between, or directly link, the EU IUU system and the evolving US system.</p> <p>2) The TPP agreement could establish a platform for TPP parties to move towards current best practice in import measures (the EU system) or a linked US-EU import system.</p> <p>3) Other large import markets could join the TPP IUU platform, either through accession to the TPP (with market access as the incentive) or through separate adherence to the provisions of the agreement establishing the IUU platform (with normative leadership as the incentive).</p>	<p>1) The TTIP parties would negotiate and approve these provisions.</p> <p>2) TPP parties would negotiate and approve the IUU measures platform.</p> <p>3) Other large markets (e.g. China) would be key to expanding the coverage of the TPP platform.</p>
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Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>3. Develop a system of multilateral instruments on trade in IUU fish products.</b>	Long term	<p>Illegal fish trade is addressed in some existing multilateral instruments, but not in the trade system itself.</p> <p>1) In the FAO, the Port State Measures Agreement (PSMA) addressing landing of illegal product has 11 ratifications but is not yet in force.</p> <p>2) In CITES, several important and vulnerable marine fish species are not subject to protected trade controls.</p>	<p>1) PSMA not yet in force.</p> <p>2) Key endangered fish species (e.g. Bluefin tuna) not listed on CITES</p> <p>3) There is currently no multilateral agreement focused on trade in products of IUU fishing.</p> <p>The approach in this option seeks to use regional trade agreements to support the entry into force of other multilateral instruments and to establish, through the WTO, a code of conduct on illegal trade.</p>	<p>1) Regional trade agreements could be used to incentivize ratification, and eventual entry into force, of the PSMA. For example, parties to the TPP agreement could agree to ratify the PSMA, and to make PSMA ratification a requirement for accession to the agreement.</p> <p>2) CITES parties should work to list key fish species on CITES Appendix I or II, combined with support for industry adjustment in countries affected by the resulting restriction of trade.</p> <p>3) Key elements of best practice unilateral or regional IUU systems could be captured in a voluntary code (or reference paper) on IUU fish imports and transshipment, in the WTO, for WTO members to subscribe to.</p>	<p>1) TPP parties would need to establish this obligation in the agreement.</p> <p>2) CITES parties would need to agree to these listings and provide the required support for adjustment.</p> <p>3) WTO members participating in unilateral or regional IUU schemes could lead the development of this voluntary code.</p>
<b>4. Support expansion of private sector schemes.</b>	Short term	<p>Several private sector certification schemes include, or focus on, assessments of the legality of the fish caught.</p> <p>Marine Stewardship Council (MSC) includes a legality element.</p> <p>Species-specific legal catch systems (e.g. Barents Sea cod).</p>	<p>Many fisheries, particularly in developing countries, are not covered by effective governance, private sector certification or other schemes</p> <p>Traceability of fish products, particularly in low-capital fisheries, is very difficult.</p>	<p>1) Certification bodies should include evidence of legal harvest in certification and pre-certification systems (if not already present).</p> <p>2) Certification bodies should ensure the standards are accessible to developing country fisheries.</p> <p>3) Increase Aid for Trade (AfT) support for the development of infrastructure to enable traceability and eventual certification of fish products.</p>	<p>1) Certification bodies, both public and private, and for pre-certification, fish buyers and fishing industry would need to be involved.</p> <p>2) Private and public fisheries legality and sustainability certification bodies.</p> <p>3) AfT donor and recipient governments' involvement required.</p>

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Work Package 2: Disciplining fisheries subsidies</b>					
<b>5. Developing reliable data on fisheries subsidies.</b>	Short Term	WTO members are obliged to notify fisheries subsidies under the Agreement on Subsidies and Countervailing Measures (ASCM). TPP parties are also likely to be subject to an additional obligation to notify their fisheries subsidies. The OECD and others maintain databases of notified and estimated subsidy levels. The G20 receives reports on certain subsidies from different IGOs.	Despite the obligation in the WTO, notification of fisheries subsidies is patchy. There are very few sources of independent assessments of real subsidy levels against which to assess notifications, and also no strong consequences of not fully notifying. Independent (IGO, NGO, academic) databases and reports are helpful, but coverage of countries is limited, and in some cases must rely on estimates.	<ol style="list-style-type: none"> <li>1) Further support to the development of comprehensive independent databases of fisheries subsidies (similar to the OECD's work on agricultural subsidies) that could be used by NGOs to publish independent subsidy analysis.</li> <li>2) WTO members could file counter-notifications of fisheries subsidies.</li> <li>3) Specific additional notification requirements for fisheries subsidies could be established in the WTO.</li> <li>4) The WTO Secretariat could reference counter-notifications by governments, or analysis by IGOs or NGOs in Trade Policy Reviews.</li> <li>5) Committees in the TPP could reference analysis or counter-notifications by governments or NGOs their review of members' notifications.</li> </ol>	<ol style="list-style-type: none"> <li>1) The academic, IGO and NGO community would need to lead this independent research and assessment work.</li> <li>2) WTO members would need to file these counter-notifications, but would rely on IGO, NGO, and academic research.</li> <li>3) WTO members would need to agree this, perhaps as a decision in the SCM Committee.</li> <li>4) The WTO Secretariat would do this, but would require the support of WTO members.</li> <li>5) TPP Parties would need to lead this in the relevant TPP committees, relying on IGO, NGO, and academic research.</li> </ol>

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>6. Core group of countries adopts fisheries subsidies disciplines.</b>	Short Term	TPP may include disciplines on subsidies to overfished stocks and IUU vessels.	Any plurilateral disciplines would need to cover several large subsidizers (EU, China, Chinese Taipei, Russia) to be effective.	<p>RTA outcomes could be used as a stepping stone towards multilateral disciplines by way of a plurilateral agreement on subsidies, subscribed to by a “core group” of large subsidizers, built by one or more of the following options:</p> <p>1) Accession to an RTA would require acceptance of the RTA’s subsidies disciplines in exchange for preferential market access.</p> <p>2) RTA disciplines could also become a “stand alone” code that large subsidizers would have political incentives to join.</p> <p>3) The US could push to introduce TPP disciplines into the TTIP agreement, binding the EU.</p> <p>4) Other regional agreements (e.g. ASEAN, the Pacific Alliance, Caricom, African TFTA) could also adopt subsidy disciplines on a regional basis.</p>	<p>1) RTA parties would need to agree to the accession of others on condition that they accepted subsidy disciplines.</p> <p>2) RTA parties and others would need to build this stand-alone agreement.</p> <p>3) RTA parties would need to push this, with the support of NGOs and some European countries.</p> <p>4) Governments that are parties to regional agreements would need to push this, with support from local civil society.</p>

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>7. Establish multilateral disciplines built stepwise and bottom up based on a plurilateral deal.</b>	Long Term	TPP may include disciplines on subsidies to overfished stocks and IUU vessels.	Important potentially harmful subsidies appear to not be part of TPP and other RTA disciplines, particularly subsidies to fuel and vessel construction.	<p>The stepping stone of a plurilateral agreement could eventually be multilateralized in the WTO if there were enough large subsidizers involved. There are several options for this:</p> <p>1) Parties to plurilateral disciplines (and members of a wider core group) would re-commit in the WTO to agreed subsidy disciplines in the form of a most-favoured-nation agreement or voluntary code.</p> <p>2) The core group would then negotiate the phase-out of the remaining important subsidies in the “ambition gap”: e.g. fuel, construction.</p> <p>3) Accession by other WTO members to the agreement (or code) would require adherence to the basic disciplines agreed by the core group and commitment to phase-out of the gap subsidies.</p>	A core group of major subsidizers would need to be involved for this series of steps to be effective in the WTO.

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>8. Restart WTO negotiations based on areas of (relatively) more agreement.</b>	Medium Term	WTO Chair's 2011 report: areas of (relatively) more agreement are subsidies to IUU vessels, transfer of vessels, and access agreements.	Subsidies to overfished stocks arguably could have been listed. FAO lists 29% of stocks as overfished.	The first-best option – an ambitious multilateral agreement – could be pursued by restarting the WTO negotiations based on: 1) Areas of (relatively more) agreement: subsidies to IUU, transfer of vessels, access agreements (maybe also overfished stocks). 2) The subsidies that evidence suggests are most likely to be harmful (construction, fuel) and focus on developing a way of phasing them out.	WTO members would lead this, with support from the scientific community on the evidence of harm.
<b>9. Align incentives by focusing international subsidy negotiations on international stocks.</b>	Long Term	WTO negotiations cover subsidies to both exclusive economic zones (EEZ) and High Seas.	Countries' main interest is in a collective agreement relating to shared stocks. Coverage of purely domestic stocks in the same agreement reduces countries' interest in participating.	1) Restart the WTO negotiations giving a higher priority to subsidies that affect international stocks (discrete high seas, shared, straddling, highly migratory), then expand disciplines to EEZ subsidies. 2) Build evidence around impact of domestic subsidies on domestic fish stocks in key countries. 3) Lobby for reform of domestic fishing subsidies.	1) WTO members would need to lead this, with support from the FAO around which stocks would fall within the new scope. 2) National governments, the research community and NGOs would need to build this evidence. 3) Local civil society would need to push this.
<b>Work Package 3: Tariffs and non-tariff measures</b>					
<b>10. Differentiate between capture and aquaculture fish in HS tariff codes.</b>	Short Term	Already being considered in World Customs Organization.	Decision pending.	Encourage governments to support differentiation decision.	National customs authorities would need to move this decision.

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>11. Support preference-dependent countries to adapt.</b>	Short Term	Few preference agreements allow “global sourcing”.	Renegotiated preference agreements should allow more flexible sourcing to balance the loss of competitiveness as preferences are eroded.	Negotiate more flexible rules of origin for fish products, conditioned on fish meeting sustainability and legality requirements, in European Partnership Agreements and preference agreements. Least developed countries are presumably covered by duty-free and quota-free market access.	Preference-giving and receiving countries would need to negotiate this in their agreements. There may be a case for international financing mechanisms, including under the AfT initiative, to provide technical assistance for producers to adjust to a loss in competitiveness caused by preference erosion.
<b>12. Support low-income fish exporting countries to adapt by providing support to reach standards.</b>	Short Term	Aid for Trade, International Trade Centre (ITC) and WTO technical assistance provided for countries to meet standards.	Support appears to be insufficient.	Fish importing countries could re-orient AfT or tariff revenue to adaptation support.	Fish importing countries would need to reshape their tariff revenue use and AfT supply priorities. AfT donor and recipient countries would need to reshape their AfT demand priorities. The private sector has a leadership role in this recommendation. Private actors are well positioned to both improve access to certification schemes and assist producers and retailers to work towards bridging the gap between production realities and sourcing requirements (as conducted in FIPs).

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>13. Ensure coherence between private standards and the TBT Code on standards.</b>	Medium Term	Some private standards may reflect TBT (Technical Barriers to Trade) principles	Some private standards may not reflect TBT principles	1) Encourage private sector standard-setters to follow the principles of the TBT Code of Good Practice on standards. 2) UNFSS and ITC standards platforms could focus on fisheries product standards.	1) Private sector standard-setters and certification bodies. 2) UNFSS and ITC Secretariats.
<b>14. Link mutual recognition systems for standards applicable to fish products.</b>	Long Term	National sanitary and phytosanitary (SPS) and TBT systems vary, and are applied inconsistently. TTIP, TPP considering mutual recognition (MR) provisions.	MR between large markets can exclude other producers and reduce their competitiveness, even if their countries' systems meet the standard.  Transmissible mutual recognition built into RTAs is a novel approach.	Large regional trade agreements' MR systems should allow non-parties systems to achieve mutual recognition if they are recognized as meeting the required standard by any one of the parties to the RTA.	TPP, TTIP Parties.

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The experts all participated in their personal capacity. The views and  
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# The Functioning of the WTO: Options for Reform and Enhanced Performance

Policy Options Paper



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# The Functioning of the WTO: Options for Reform and Enhanced Performance

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on behalf of the E15 Expert Group on the Functioning of the WTO

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on the Functioning of the WTO. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15 Initiative and authored by group members. Manfred Elsig was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:  
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# Abstract

The multilateral rules-based trading system has been crucial in helping states to cooperate and gradually open up borders to encourage trade and investment for development. It has contributed to temper unilateral approaches and to integrate emerging economies over time. Yet the WTO is currently at a crossroads and is facing an “adaptability” crisis. The world economy has changed since the organization was created, and new and complex challenges are quickly adding to an already loaded agenda. A key question is whether the WTO is capable of responding to these challenges or whether there is instead a need to revisit the basic foundations on which the multilateral trading system has evolved over the past six decades. The present paper analyses potential avenues for reform to ensure the future success and relevance of the WTO. It offers policy options for consideration in three areas: the negotiation function of the WTO; the role of committees within the organization; and the involvement of the business sector. First, in order to improve the negotiation function, the paper

advocates that a grand bargain be reached to create a package that allows the Doha Round to be concluded, which would be constructed by combining commitments where progress has been made with an explicit acceptance of the move towards using plurilateral approaches within the ambit of the WTO. The latter would be accompanied by a new committee or working group whose mandate would be to work out optimal design features for these plurilateral approaches. Second, recommendations are put forward to increase the role and impact of committee work, with the objective of enabling the system to mature and deliberate on new avenues for rule-making. Third, in order to enhance the involvement of the business sector with the WTO, new platforms for institutionalized interaction are proposed. These include the creation of a Business Forum and Business Advisory Council to establish a formalized dialogue between business and the intergovernmental system. The paper concludes by outlining practical policy steps to implement the proposals in each of the three areas.

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Abbreviations	
BAC	Business Advisory Council
BBF	Bali Business Forum
BF	Business Forum
DG	Director-General
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
MFN	most favoured nation
NAMA	non-agricultural market access
PA	plurilateral agreement
PTA	preferential trade agreement
RTA	regional trade agreement
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
WTO	World Trade Organization

# Executive Summary

The WTO is at a crossroads. Not only are the multilateral trade negotiations stuck, but overall rule-making has made little progress while alternative trade pacts, not least the mega-regional arrangements, have clearly challenged the position of trade multilateralism. The organization is currently facing what can be called an “adaptability” crisis. The world economy has changed since the WTO was created back in the mid-1990s, and new challenges are quickly piling on top of the old ones. The rise of emerging countries and the relative decline of traditional economic powers, their various negotiating demands and approaches, the proliferation of preferential trade agreements, and the need to deal with complex new issues, such as climate change and food security, are all shaking the foundations on which the WTO was built some twenty years ago.

A key question is whether the WTO is capable of responding to these new and complex issues or whether there is instead a need to revise the basic foundations on which the multilateral trading system has evolved over the last 60-plus years. Should the WTO’s current mandate be expanded? Or is it best to complete the unfinished business of the Doha negotiations before taking up new negotiating initiatives? What should be done to strengthen the multilateral trading system and to ensure the future success of the WTO?

These are some of the multifaceted questions addressed by the E15 Expert Group on the Functioning of the WTO, jointly convened by ICTSD and the World Economic Forum with the support of the World Trade Institute as knowledge partner. The overall mandate of the Expert Group was to identify and propose for consideration a set of policy options to strengthen the negotiating, monitoring, and deliberative functions of the WTO. The present paper, which is the outcome of this expert dialogue process, lays emphasis on the negotiation and deliberation capacities of the multilateral system and also focuses on the relationship between the business sector and the WTO. These are governance challenges that the system needs to address in the years to come.

## Background

Over the past six decades, the multilateral trading system has provided an unprecedented level of stability and predictability in the way WTO members conduct their trade operations. It has also provided—particularly since the establishment of the WTO—a credible and solid mechanism to adjudicate trade disputes, one that is guided by law rather than power. Developing countries, most of which steered clear of the system during the GATT years, have for the most part joined the WTO, making the system a truly universally accepted set of values and rules, and not the rather limited “club” that it used to be.

A renewed sense of international cooperation among WTO members is essential for dealing, first and foremost, with the unfinished business of the Doha negotiations. Completing the Doha Round would allow the WTO to focus on some of the most pressing challenges the system now faces: defining a new set of negotiating modalities for the future, strengthening its institutional framework—i.e. the functioning of its various committees, and revisiting the traditional approach to the participation of the private sector.

The paper sketches a number of challenges to multilateralism in general, which impact the way WTO members negotiate and deliberate. It then suggests a number of incremental reforms that could help re-energize the negotiation function of the WTO and increase the potential of committee-related work, in particular in view of agenda-setting and preparation for rule-making. Finally, support of private actors, such as business groups, is important to sustain the system. Concrete ideas on how to institutionalize these relations are outlined.

## Policy Options

In order to improve the performance of the negotiation function, the paper advocates an extra effort to create a package that allows the Doha Round to be concluded. This consists of a grand bargain to agree on what it is possible to achieve while allowing, strengthening, and channelling new plurilateral approaches. The latter would be accompanied by a new WTO committee, or working group, whose mandate would be to work out optimal design features for these plurilateral approaches.

In addition, the paper suggests increasing the role and impact of committee work. A set of objectives are listed that might allow the system to further mature and elaborate the “Geneva-way” through consultation, elaboration, debate, and deliberation on new avenues for rule-making. These include better data management, improving committee leadership and overall coordination, using more in-house expertise, improving the quality of exchange to allow for more deliberation, bringing on board more domestic decision-making, and reaching out to the public.

Finally, in order to enhance the involvement of the business sector, new platforms for interaction are advocated that could assist in building a shared understanding of challenges and policy options, allowing for critical feedback and the elaboration of new ideas for regulatory innovation in rule-making. Two institutional proposals stand out. First, the creation of a Business Forum which would meet around the time of the ministerial meetings; and, second, the creation of a Business Advisory Council to establish a formalized interaction between interested businesses and the intergovernmental system.

## **Next Steps**

The majority of proposals outlined in the paper can be implemented in the short to medium term if the WTO members show willingness. None of the policy options would require major institutional changes. What is clear is that the initiative to address governance issues needs to grow from within the organization. In light of this, the paper concludes by describing potential policy steps to implement the proposals in each of the three areas the Expert Group focused on.

# 1. Background Challenges

The multilateral trading system has been crucial in helping states to cooperate and gradually open up borders to encourage trade with a view to fostering sustainable development. A rules-based system has contributed to temper unilateral approaches and to integrate emerging economies into the global trading system over time. A key aspect of the multilateral system is how it functions and how governance is organized. Needless to say, the legitimacy of the WTO is strongly affected by how well it functions, how it aggregates the different interests, how it allows for deliberation, and how it interacts with outside actors (Elsig 2007).

The E15 Expert Group on the Functioning of the WTO, jointly convened by ICTSD and the World Economic Forum with the support of the World Trade Institute as knowledge partner, focused on how the WTO makes decisions and develops new rules. It follows in the footsteps of past research and policy work, most prominently the analyses and recommendations of the so-called Sutherland Group (WTO 2004) and The Warwick Commission (2007).<sup>1</sup> While many outside experts have lamented the slow progress in negotiations, there has been little “official” debate about this within the system. The Ministerial Conference in 2009 was set up partially to review WTO governance issues; however, only a few countries made formal submissions and those that were presented were largely general in nature and did not lead to much engagement and discussion in the Ministerial gatherings.

The Expert Group chose to lay emphasis on the negotiation and deliberation capacities of the system. It did not address other key aspects such as the dispute settlement system, which seems to work rather well, nor technical assistance, capacity building, outreach activities, or research and statistics. Also, the Group focused on the business sector as a key outside constituency to highlight the limits and the potential of increased interaction. These lessons can be illustrative for other interested stakeholders and their relations with the system, such as civil society organizations. The deliberations of the Expert Group were organized under the following categories.

1. The negotiation function
2. The role of committees
3. The involvement of the business sector

While little progress in new multilateral WTO deals has been made in recent years, some movement has been observed in plurilateral negotiations since the single undertaking principle was questioned from within the system. The Uruguay Round’s single package approach is not working in the Doha Round and new types of negotiation modes have been advocated. The single package approach was *de facto* given up at the Ministerial Conference of 2011. In WT/MIN(11)/11, page 3, Ministers’ agreed text states: “Ministers acknowledge that there are significantly different perspectives on the possible results that Members can achieve in certain areas of the single undertaking. In this context, it is unlikely that all elements of the Doha Development Round could be concluded simultaneously in the near future. (...) In this context, Ministers commit to advance negotiations, where progress can be achieved, including focusing on the elements of the Doha Declaration that allow Members to reach provisional or definitive agreements based on consensus earlier than the full conclusion of the single undertaking.”

As to the committee work, its effects have been largely overlooked (see for instance Wijkström 2015). This is an area where potential scope for incremental progress exists.

Finally, whereas the business sector has not withdrawn from the WTO system, it has clearly lost its enthusiasm. New ways of involving the business sector could prove instrumental for achieving progress in rule-making in the future.

A number of background challenges impact on how the WTO functions. Six challenges that affect the WTO regime management stand out.

First, until the 1990s, the world trading system was characterized as a club in which trade diplomats met behind closed doors to agree on gradual liberalization. The creation of the WTO led to a deepening of trade concessions and provided WTO members with a highly legalized dispute settlement system to support implementation. As a result of this move towards market integration and legalization, many new actors brought their issues and concerns, sometimes only partially linked to trade, to the WTO. They were encouraged by the fact that the Uruguay Round Agreement gave rise to a number of areas which were not previously considered as directly relevant to trade, such

<sup>1</sup> There are numerous contributions by experts and scholars that focus on issues related to governance (for example Deere-Birkbeck and Monagle 2009, Steger 2009, Elsig and Cottier 2011, Narlikar et al. 2012, Meléndez-Ortiz et al. 2012).

as the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) or the Agreement on Trade-Related Investment Measures (TRIMs). Since the late 1990s, the WTO has undergone an adjustment process in reacting to this increasing scale of public attention. Incrementally, the organization has become more transparent and has worked on its inclusiveness (in particular with internal stakeholders). Yet finding the right balance between allowing WTO negotiators some wiggle room and providing a flow of information on the negotiations has proven difficult. Put differently, open and fully inclusive negotiations will make it difficult to negotiate effectively.

Second, the General Agreement on Tariffs and Trade (GATT) system created in 1947 was dominated by the US and embedded within a strong liberal consensus (Ikenberry 2006, Ruggie 1982). During the last successful trade round, the leadership became more broadly shared. On the one hand, the European Union, represented by the European Commission, started to become more assertive in trade negotiations and on the other hand, the QUAD group (which included, in addition to the transatlantic partners, Japan and Canada) served as an important informal platform for agreeing on major issues enabling the round to move forward. Today, we have clearly moved towards a multipolar trade world. In particular, China, Brazil, and India play an important role in the system, acting on their own or as part of coalitions (Narlikar 2011). The impasse of the Doha Round is not so much a result of transatlantic disagreement as a situation in which highly industrialized countries and large developing countries disagree over the type of market access and protection of vulnerable sectors of the economy.

Third, the new preferential trade agreement (PTA) landscape offers a challenge to the organization. Most WTO members have turned their attention towards this negotiation venue, driven largely in many circumstances by exporter discrimination concerns (Dür 2007, Manger 2009, Elsig and Dupont 2012). In addition, strategic, geopolitical, or regional political aspirations affect the choice of partners and the overall ambitions. As a consequence of this evolving domino effect, if countries improve selected market access through small group deals, the appetite for negotiating ambitious multilateral solutions might well decrease. In particular, initiatives, such as the concluded Trans-Pacific Partnership (TPP) Agreement and the ongoing negotiations on a Transatlantic Trade and Investment Partnership (TTIP) show new potential sources of discrimination on the horizon. This new type of mega-regionals will most likely lead to additional efforts among states to remedy potential disadvantages emanating from these agreements. They will play a central role in creating new templates, in affecting the location and development of global value chains, and shaping the content of future PTAs. Whatever the complementarity to the multilateral trading system, potential substitution effects, or emerging discrimination, this “new regionalism” will require a different response from the WTO than the current one.

Fourth, the WTO is faced with the legacy of the Uruguay Round grand bargain (market access for developing countries in agricultural products and textiles vs. services liberalization and intellectual property rights protection for developed countries) described by Sylvia Ostry (2002). For many developing countries, however, this deal was later perceived as asymmetric, because many countries have not yet reaped the benefits that should have resulted from the original bargain. In addition, many low-income developing countries continue to struggle to meet their WTO obligations. This phenomenon has further increased the expectation held by developing countries that the Doha Round will mainly need to deliver on development. These expectations contrast with demands by industrialized countries to significantly improve market access in larger developing countries. Therefore, it is difficult for the WTO to deliver, given the sharp differences in countries’ expectations of the objectives of the round. This unfolding expectation–capacity gap continues to loom large in the current environment of negotiations.

Fifth, we have witnessed important changes in the way goods production and services provisions are organized across borders. The increasing reliance on production networks and outsourcing has led to a growing importance of the existing behind-the-border rules. This creates new challenges in the negotiation process. While in the early days of multilateral trade liberalization, progress in negotiations occurred within a framework of reciprocal lowering of trade barriers, such as tariffs (a form of so-called negative integration), we have now moved towards addressing barriers that exist behind the border. These obstacles range from non-tariff barriers to specific investment clauses, different intellectual property rights regimes, and diverging competition norms (WTO 2011). The unfolding challenge consists in finding the optimal degree of positive integration (in agreeing standards that are acceptable to all parties involved). This type of agreement on regulatory cooperation and coherence has been at the heart of the negotiations in the TPP and TTIP. In addition, new challenges of positive integration are waiting to be resolved pertaining to 21<sup>st</sup> century trade topics, ranging from technological advances and tradable services to questions related to data protection.

Sixth, we deal with a somewhat unintended consequence of legalization. The enforcement mechanism of the WTO (“the jewel in the crown”) has led to dynamics that additionally impact on trade negotiations. Under the shadow of a strong dispute settlement system, where concessions can actually be enforced, parties are sometimes reluctant to commit to future deals, and this has important distributional consequences as domestic interest groups grow more vigilant (Goldstein and Martin 2000).

# 2. Three Areas for WTO Reform

In the following we describe the challenges related to the three areas the Expert Group focused on: the negotiation function, the role of committees, and the involvement of the business sector.

## 2.1. The Negotiation Function of the WTO Remains Comatose

For a long time, it was conventional wisdom that the negotiation function is the most important activity of the WTO within its mandate. Now that we are fourteen years into the Doha Round, this assessment regrettably needs some qualification. The WTO has produced few outcomes in negotiations since the late 1990s when it concluded the Information Technology Agreement, the Basic Telecommunications Agreement, and the Financial Services Agreement, which were mainly characterized by a “critical mass” approach. In addition, a part of the membership negotiated and concluded a plurilateral, club-like agreement on public procurement. These outcomes resulted from Uruguay Round left-overs that were successfully tackled. Most recently, we witnessed the conclusion of an adapted agreement on information technology and some progress on the issue of trade facilitation has been achieved. In fact, the Agreement on Trade Facilitation, which was reached in 2013 and will enter into force once two-thirds of the WTO membership have ratified, has been the only noteworthy multilateral agreement outcome since the creation of the WTO. Most negotiations in the Doha Round, however, have been deadlocked for a number of years.

What has changed? What can be observed is that there is more participation. In particular, the growing importance of some large developing countries in decision-making has diminished the previous significance of the US and the EU in this context. The information asymmetry between different contracting parties has also decreased, expertise is more widely spread among the membership, and the formal small group meetings allow for broader participation reflecting the interests of additional parties. There seems to be greater inclusiveness, yet, not surprisingly, many deals continue to be discussed in informal small group meetings, mostly outside the WTO premises. Small group outcomes are still pivotal for success, but are not sufficient for progress to be made. Before agreement in the core group can be multilateralized in the Geneva process, opportunities need to be provided for input from the membership at large. Judging from the evolving processes, one could argue that the system has incrementally adjusted (without rule

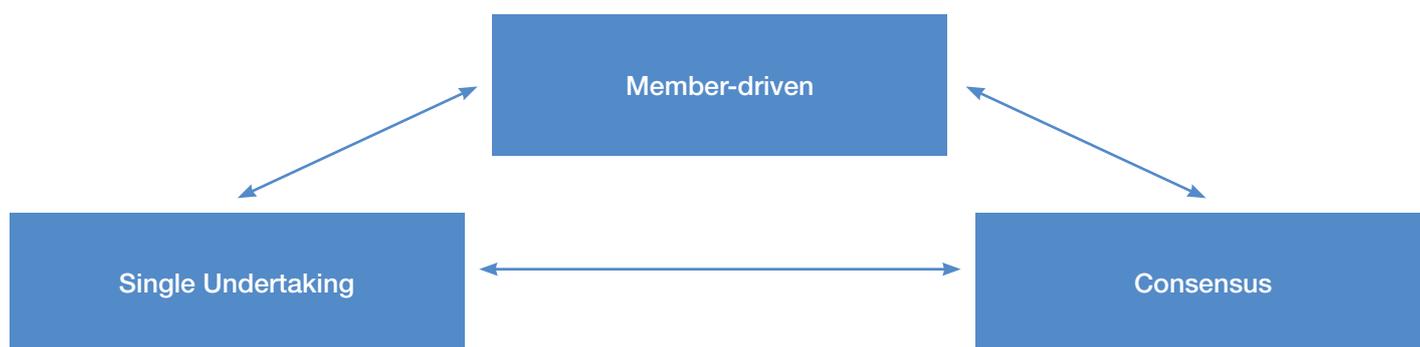
changes) to demands for more participation. Also, there has been less criticism about a lack of inclusiveness than in the past. However, other parameters have impacted negatively on the negotiation function, as described above—i.e. more interests leading to collective action problems, need for positive integration, legalization’s effect on commitments, outside options through PTAs, and disagreement on development objectives.

One view is that the decision-making triangle is incompatible with the new challenges. Elsig and Cottier (2011) picture the WTO system as relying on three pillars: the single undertaking, consensus decision-making, and the member-driven character of the organization (see Figure 1). They argue that this triangle has become unsustainable. Presenting a counterfactual argument, they investigate the effects of loosening one of the three pillars. They briefly develop three different scenarios. In scenario one, the WTO gives up a strict reading of the single undertaking and moves towards a system that allows for more plurilateral approaches. This scenario has somewhat become reality. Of the proposals that have been put forward, the critical mass initiative has received most attention. Other proposals included the possibility to allow for early harvest or moving towards a legislative system where issues would be taken up as they arise, a path that currently seems unlikely. Scenario two would foresee a system in which the consensus principle would be weakened by moving towards qualified majorities in selected negotiation areas. While key decisions could still be taken by consensus, other lower-level (or secondary) decisions could be negotiated under some form of voting. It is important to note that voting is already allowed in the WTO system. It is not used because it is based on a one-state one-vote principle, which the US and other large economies would not embrace, and also because the consensus principle has become the accepted means of decision-making. This “we-don’t-vote-in-this-organization-mantra” blocks discussions on adjusting the voting system. Finally, the third scenario assumes that a big obstacle to tabling concessions rests on sovereignty concerns embodied in the member-driven character of the organization. This reluctance to delegate keeps the autonomy of chairs in the negotiations (who are recruited among the membership) limited.<sup>2,3</sup> In addition, member dominance keeps the WTO Secretariat (who could potentially play the role of guardian of the multilateral rules) on the sidelines in the negotiation process. The

<sup>2</sup> In earlier trade rounds, even Secretariat officials were tasked to chair negotiation groups (Elsig 2011).

<sup>3</sup> In the GATT era, GATT contracting parties attempted to set up a smaller group composed of capital-based officials to provide guidance in the negotiation process and to limit the number of parties as a means of partial delegation; see consultative Group of 18 (Blackhurst and Hartridge 2005 and Abbott 2013).

**Figure 1: The Incompatible Triangle**



Source: Adapted from Elsig and Cottier 2011

members see themselves as the guardians. Are there ways to empower some actors to address the problem of lack of incentives for individual members to table concessions and move from value-claiming to value-creating negotiation strategies (see also Odell 2009)? This third scenario also seems highly improbable.

Looking at these scenarios, there is evidence, as mentioned above, that the single-undertaking pillar has been weakened. The “single undertaking” is no longer a negotiating tool. It could be argued that the principle has become a way for those countries least willing to take on new commitments to hold the negotiations hostage. If the GATT negotiating history is to offer any lessons, it is that every negotiating round has always left aside some pending issues, with the goal of addressing them later on in future rounds. Even the Uruguay Round, despite being based on the “single undertaking,” was not an exception to this rule, as it left aside a number of issues in agriculture and trade in services—the famous “built-in agenda”—with the goal of addressing them later in a post-Uruguay Round environment. Thus, the practice and new understanding of the “single undertaking” has made progress in negotiations difficult.

As a result, plurilateral approaches have undergone a revival. Four types are evident: new mega-regionals (in particular TPP and TTIP), which are negotiated under the exception rule for so-called regional trade agreements (RTAs); plurilaterals within the ambit of the WTO excluding most-favoured-nation (MFN) treatment (e.g. public procurement) or providing MFN treatment for non-participants (e.g. information technology agreements); and plurilaterals which are linked to, but still separate from, the WTO system (e.g. Trade in Services Agreement—TiSA). Notwithstanding limited progress tangential to the Doha Round negotiations, there needs to be some form of conclusion of these talks. The negotiation arm can no longer remain comatose.

## 2.2. The Potential of Committees is not Fully Exploited

In the shadow of the stalled negotiations, important activities occur within numerous WTO committees. While the mandates of the regular or special committees might differ, they all operate towards managing the regime. They do so by exchanging information, collecting data, overseeing notification processes where WTO members inform each other about national developments, and in particular by assisting in implementing the WTO obligations which parties committed to. In addition, these interactions might often lead to an exchange of views on best practices and eventually to the elaboration of new norms. An interesting question is how the work of regular committees has been impacted by the stalled round and to what degree various committees could be used as platforms to rekindle the interest in certain areas of trade regulation. What are the possible ways to strengthen the work of the regular WTO committees, enabling them to break away from a business-as-usual approach?

An important element in all committees is the focus on increasing transparency regarding the trade policy measures implemented by states. While some committees actively oversee conventional notification requirements about planned regulatory reforms (e.g. the Committee on Technical Barriers to Trade (TBT) for technical standards and the Committee on Sanitary and Phytosanitary (SPS) Measures for issues of food safety and animal and plant health), the committees also allow for discussion and reflection. This latter function is important in committees; however, the mandates are not always clear as to the degree to which discussion should lead to more deliberation and eventually to the elaboration of new shared norms. The question arises whether and how regular committees could initiate a discussion on pressing challenges which are not really addressed in the negotiations (e.g. climate change and trade, exchange rates, or high and volatile food prices).

While the focus of the regular committees is on compliance, a question is what would be needed to use existing institutional venues to go beyond this role and offer a more deliberative function?

Some of the literature suggests increasing the potential impact of committees (Wijkstrom 2015). Lang and Scott (2009) emphasize the creation of shared knowledge that could lead to the elaboration of new shared norms. One committee that has received attention is the RTA Committee. Given the importance of the growing numbers of PTAs, the WTO membership has given new tasks to this committee. Overall, however, the question remains how to improve the overall impact of committees.<sup>4</sup>

### 2.3. The Lack of Institutionalized Exchange of Information with the Private Sector

During the past decade, the willingness of private sector actors to invest time and resources in multilateral trade negotiations seems to have been eroded. This increasing ambivalence towards multilateral trade reforms is due to a combination of complacency (i.e. taking the free flow of goods and services for granted), discontentment with the slow pace of WTO discussions in general and the standstill of the Doha Round in particular, and a growing feeling that the WTO does not effectively respond to today's business concerns, such as the operations of global supply chains. As a result, private actors have been actively pushing national policy-makers to explore venues other than the WTO to fulfil their trade policy needs. Especially notable in this regard is the shift in lobbying efforts from multilateral trade deals to bilateral agreements, as the latter take much less time to negotiate and are usually shaped in such a way that they include more of the issues regarded important by the business community.

If the WTO wants to reverse this trend of private actors partly turning their back on multilateralism, it seems vital for the organization to engage much more than it does at present with large and small businesses in both developed and developing countries. This is important for several reasons. For one, private actors' involvement and support could play a crucial role in re-energizing the Doha Round. Second, the more active involvement of private actors could make the WTO more effective and strengthen its legitimacy. After all, by taking on board the input of businesses, the WTO would involve one of the groups that is most influenced by decisions on global trade rules. Third, it can help to promote an understanding of the core principles of the WTO if private actors have the feeling that their interests and concerns are taken into account. Fourth, it would enable the WTO to tap the expertise and knowledge of private actors. By engaging more with private actors, the WTO has the opportunity to enrich the nature and the quality of the information it receives at all stages of its decision-making and in all its functions.

The best way to ensure more active involvement of private actors with the WTO is to set up a system which enables the WTO and the private sector to interact much more systematically and in a more structured manner than is currently the case. The WTO and its members have acknowledged in the past that the participation of private actors is perfectly in line with the intergovernmental character of the organization (WTO 2004). However, the current engagement is essentially based on a series of *ad hoc* mechanisms and practices. In 1996, for instance, the General Council adopted guidelines which were aimed at, among other things, enhancing transparency and developing communication with private actors and other non-state actors. What is more, over the years, the WTO has organized an increasing number of outreach events in which it engages with private actors, such as briefings for non-state actors on WTO council and committee meetings, plenary sessions of ministerial conferences, and symposia on specific issues, which private actors and other non-state actors can attend, and the annual public forum, which the WTO has been hosting since 2001 (between 2001 and 2005 it was called the public symposium). The WTO also runs training programmes in different parts of the world to train the private sector on specific WTO-related issues. Despite the WTO's efforts to engage with private actors, the multilateral trading system still lacks, in the words of Deere-Birkbeck (2012, 123), "adequate routine mechanisms and processes for the constructive engagement of stakeholders, whether from unions, nongovernmental organizations, academia, or the business sector, in ways that feed into decision-making processes to ensure trade rules respond to public concerns and expectations."

<sup>4</sup> Most contributions focus on the Trade Policy Review Committee and suggest a widening of its mandate (e.g. Chaisse and Matsushita 2013, see also Abu-Ghazaleh 2013), on bringing in more stakeholders (Hoekman 2012), on being tougher on the WTO members (e.g. Keesing 1998, Zahrnt 2009) or on discussing the reports in the countries concerned (Zahrnt 2009).

# 3. Policy Options to Improve the Functioning of the WTO

## 3.1. Improving the Performance of the Negotiation Function

It is clear that for the WTO to matter in the years to come it needs to produce tangible results through negotiations. At the same time, the non-conclusion of the Doha Round presents a big challenge because it reminds those inside and outside the system that the WTO cannot deliver. Therefore two proposals are put forward. One is to finish the round and seek—if possible—another more sustainable grand bargain. The other suggestion is to actively provide more guidance for plurilateral approaches (beyond the PTAs and mega-regionals).

### 3.1.1. Seeking a final grand bargain

The new deal could be constructed by combining specific commitments where progress has been made over time with an explicit acceptance of the move towards using plurilateral approaches within the ambit of the WTO (and therefore putting an end to the single undertaking approach once and for all). One side of the bargain would therefore be composed of major elements of the Doha agenda based on existing results where near universal support exists in areas such as agriculture, non-agricultural market access (NAMA), rules, and trade facilitation. At present, of all the Doha issues, an agreement on NAMA—i.e. on the market access negotiations on goods—is the one that holds the promise of moving the negotiations towards a final deal. The situation that WTO members face today is not unlike the one faced by GATT members in the early rounds, namely the need to reach an acceptable level of tariff cuts among the key trading partners, including China and the other emerging economies. Thus, strange as it may seem, tariff cuts may help to alleviate the paralysis in the other areas of the negotiations and the finalization of a global pact, just as they have traditionally done. It may seem ironic that a protectionist device that most analysts have written off as insignificant and outmoded could continue to play such an important role in today's negotiations. However, the reason may lie not in the intrinsic value of tariff protection, but rather in the visibility that it would give to a negotiating package. In politics, reality almost always takes a back seat to perception, and in developed countries the perception that some countries are “free riding” in the negotiations has taken a strong hold.

This first side of the bargain would be conditional on a second side—authorization of future negotiations of a specified list of plurilateral agreements (PAs) (Odell 2013). Article II.3 of the WTO Agreement authorizes such agreements that bind only the states that sign them.<sup>5</sup> Designers of the package could select particular PAs in part to generate the interest of disaffected constituencies. For instance, they could include pacts to liberalize services trade in general, PAs on particular services such as telecommunications beyond basic services, and zero for zero tariff deals in particular sectors of goods trade.

### 3.1.2. Designing optimal plurilaterals to save the negotiation function

Related to the above, the creation of a committee or a working group on the institutional development of PAs is suggested; it would be tasked with elaborating suggestions on how to move forward with different types of plurilateral approaches. Given the proximity to PTAs, the work could also be carried out by the Committee on RTAs. If a special committee is established it would have to consult closely with RTA Committee, but the mandate could be much more ambitious. This committee would be tasked with elaborating rules for the different types of PAs, namely:

- PAs that extend benefits to all WTO members on an MFN basis (that is, unconditional plurilaterals);
- PAs that extend benefits only to signatories (that is, conditional non-MFN plurilaterals); and
- Rules for sectoral agreements (not yet linked to the WTO—e.g. TiSA).

Beyond the procedural rules, the committee should work towards finding the appropriate approach and set-up for specific market access demands. This re-examination should also pay particular attention to the potential impacts on those that choose not to participate (Vickers 2013). The committee should be chaired by the Director-General (DG) and should be able to take decisions by supermajority vote. It could also be useful to explore whether the committee could be formed under the Trade Negotiations Committee, which is already chaired by the DG.

<sup>5</sup> Art. X.9 of the Agreement on Establishment of the World Trade Organization, which requires consensus for plurilaterals, might need to be revisited.

## 3.2. Strengthening the Role and Impact of Committee Work

As outlined above, the WTO membership should seek to increase the potential impact of the work carried out collectively by committees (Elsig 2013b). The following objectives in particular might allow the system to further mature and elaborate the “Geneva-way” through consultation, elaboration, debate, and deliberation on new avenues for rule-making.

### 3.2.1. More systematic data management

One of the challenges is how to organize, present, and disseminate the wealth of available information. The WTO, as the leading multilateral trade institution, should prioritize and optimize processes of information management and explore the specific usefulness that an information portal has for potential users. The WTO should serve as a key information hub on regulatory matters based on its existing experience as a venue where notifications are collected and trade policy reviews conducted. The information compiled needs to be used for specific benchmarking exercises following agreed indicators. Existing attempts, such as monitoring potentially protectionist measures during economic and financial crises, are a step in the right direction, but need to be more systematic in particular with regard to increasing the impact for the users. There is a demand for more surveillance of new trade-policy relevant developments in WTO members’ constituencies. In order to do this, more resources should be devoted to data compilation, statistics, and data management.

### 3.2.2. Improving leadership and coordination

Generally, the WTO suffers from a lack of leadership in the sense that too little attention to committee work and too much rotation affect group cohesiveness. One way to address this is to devote more resources and allocate more time to chairs of committees. Currently, many committee chairs are selected for a one-year term. This is not long enough to create an optimal working environment for achieving the goals outlined above. Chairs should be elected for a three-year period and receive additional support from Secretariat officials.<sup>6</sup> Secretariat officials could be organized in a new division for committee-related work or the existing support could be further consolidated. In addition, an official standing body of chairs should be created to ensure that the information exchange among chairs, and with the WTO DG, which currently follows an informal approach, is further improved.

### 3.2.3. Making more use of in-house expertise

What is striking about the WTO compared to other international economic organizations, such as the International Monetary Fund and the World Bank, is how little use is made of the in-house expertise. WTO officials could do more than occasionally write non-papers to summarize the issues at stake. The chairs should be allowed a mandate to create *ad hoc* working groups that are chaired by Secretariat officials or jointly with member representatives. More systematically involving (and empowering) WTO staffers is important as they are the guardians of the multilateral system and have the required expertise.

### 3.2.4. Improving the quality of exchange and creating more room for deliberation

A precondition for moving towards high-quality deliberation is the availability of sufficient relevant information. If the circle of experts is too small, there is a danger that crucial information will be lacking. It is important to invite key experts to internal meetings to share their experience and expertise during the deliberations. For instance, in the case of the RTA Committee, it is necessary for chief negotiators of these PTAs to visit Geneva regularly to share their experience and discuss how they deal with issues such as WTO compatibility of PTA obligations, and to allow for input and feedback from other WTO members. The SPS Committee, for example, could intensify its relations with standardization bodies beyond existing exchanges and seek more interactions with health experts. Initiatives for cross-institutional cooperation with other international organizations should be encouraged. For deliberation to occur, good quality information is required. Another necessary condition is the creation of an environment for informal gatherings (alongside more formal meetings) to build trust and understanding between participating actors. The chairs of the groups have a pivotal role in depoliticizing discussions and buffering against existing hierarchies. If necessary, chairs can initiate the creation of *ad hoc* brainstorming or drafting groups, propose walks in the woods, and demand assistance and advice from outside experts and mediators in order to allow for deliberative processes to occur.

### 3.2.5. Locking in domestic decision-makers

There needs to be greater involvement and buy-in of domestic decision-makers. Committees need to devise a strategy on how to engage with capital-based officials and members of parliament. Their selective participation in some of the committees should be further increased. In the case of the trade policy reviews, the results of these reports should be discussed more prominently in the countries concerned. It helps that parliamentarians have started taking a greater interest in these reviews. Different ministries (for example, finance, tax, or environment) and members of parliament should be further encouraged to participate in some way in the deliberations when reports are discussed. Trade ministers should be more involved in certain committee activities either as facilitators or as friends of the committee.

<sup>6</sup> While this raises some practical problems with the lengths of diplomats’ stay in Geneva, more continuity is needed to enable chairs to play a role beyond structuring the debate.

### 3.2.6. Building bridges to the public

The public's support is important for the legitimacy of the system. There are various ways to engage with the public. While informal exchanges behind closed doors are important to allow for deliberation and to build trust, targeted initiatives to engage with the wider public are needed. These could range from providing live coverage of certain events that are managed by a committee, to allowing for a public debate when meetings take place outside Geneva and to inviting online feedback on ongoing work. Written submissions to the committees by accredited business and non-governmental actors should also be encouraged. These briefs should be disseminated among WTO members.

### 3.3. Enhancing the Involvement of the Business Sector

Although the WTO is an intergovernmental organization and decisions are taken exclusively by member governments acting collectively, the business community has an important stake in the organization's performance. It is mainly businesses, not governments, which engage in international trade, and they are bound to be affected by WTO operations. In practice, business and government interact in the WTO in many different ways, sometimes advancing the negotiating agenda and at other times ensuring that governments abide by their multilateral commitments. The support of the business sector is key to the success of the system. While many informal and formal channels of interaction exist in domestic political settings, at the WTO there is a need for more engagement. This interaction should be designed as an open, two-way process to assist in building a shared understanding of challenges and policy options, allowing for critical feedback and the elaboration of new ideas for regulatory innovation in rule-making. Two institutional proposals stand out (Eckhardt 2013). These are developed below.

#### 3.3.1. The creation of a Business Forum

The first idea would be to organize a formal Business Forum (BF) at the same time as (or perhaps starting a few days earlier than) the ministerial meetings, where business leaders could meet to share and learn from one another, and interact with heads of state as well as government and high governmental officials. The prime purpose would be to present concrete suggestions to decision-makers. More specifically, like the B20 (an event organized during the G20 meetings), the BF would put forward recommendations and would engage in issuing relevant commitments from the business leaders and business organizations to deal with current issues. Ideally, it would function as a reality check for governments, since they need business sector support for their negotiations as well as for the ratification of the results agreed. It could be possible to build on a first experience in Bali, where a pilot test for a Business Forum was organized (Box 1).

#### Box 1: The Bali Business Forum

At the Ninth WTO Ministerial Conference that took place in Bali, Indonesia, from 3 to 7 December 2013, the International Chamber of Commerce (ICC), the Evian Group@IMD, and the International Centre for Trade and Sustainable Development (ICTSD) decided to jointly organize a day-long event to focus on issues of particular interest to business representatives from WTO member countries. This event—the Bali Business Forum (BBF)—which was the first of its kind, took place on 5 December 2013.

The BBF provided an open forum where the business community could examine the most critical issues in the international trade agenda and interact with ministers and other high-level officials to contribute towards a constructive outcome in Bali. The agenda of the BBF included issues such as: (i) the quantitative benefits of a Doha deal (or costs of a Doha non-deal); (ii) the impact of mega-regional agreements (e.g. TPP and TTIP) on the WTO; (iii) the complementary nature of trade in services, trade facilitation, and global value chains; and (iv) the role of the private sector in the WTO.

An accompanying high-level luncheon focused on the topical issues at the intersection of the WTO and digital economy; and a business/ministerial roundtable wrapped up the ambitious day-long agenda in a high-level setting. Throughout the panel discussions, representatives of the private sector and government officials, including CEOs and key ministers engaged in an open dialogue on the above-mentioned topics.

The ICC, the Evian Group@IMD, and ICTSD acted as the core co-conveners of the BBF, in partnership with the Inter-American Development Bank and the International Trade Centre. The BBF also had the support of relevant business organizations and associations, such as the Washington-based National Foreign Trade Council (NFTC), the Coalition of Services Industries (CSI), the European Services Forum (ESF), and the Federation of Industries of São Paulo (FIESP).

Through engagement and dialogue between business executives and policy-makers from all over the world the BBF helped to facilitate a better understanding of the possibilities of enhanced multilateral cooperation, and on the need for a dynamic WTO.

### 3.3.2. The creation of a Business Advisory Council

A more far-reaching (and perhaps more controversial) proposal is to establish a WTO Business Advisory Council (BAC).<sup>7</sup> The BAC could promote the interests of the business community by advising and engaging with the WTO Secretariat and WTO members on a broad range of issues. Ideally the BAC and the BF would be complementary—that is, organizing the BF could be one of the key activities of the BAC. Other activities the BAC could undertake would be to:

- Actively follow the regular committee work;
- Identify priority areas for consideration by WTO and its members;
- Advise on setting the agenda for the ministerial meetings;
- Provide policy recommendations to the WTO and its members;
- Provide the WTO and its members with timely information on WTO policies and their implications for business and industry; and
- Respond when the various WTO forums request information about business-related issues or to provide the business perspective on specific areas of cooperation.

<sup>7</sup> If such an Advisory Council were to be set-up, a similar body could be envisaged channelling the different voices of civil society groups.

# 4. Priorities and Policy Steps

The majority of proposals outlined in this paper can be implemented in the short to medium term if the WTO members show willingness. None of the policy options would require major institutional changes. What is clear is that the initiative needs to grow from within the organization. It could be that different informal coalitions are formed that start a consultation process to gather support among the membership for addressing governance issues. Ideas emanating from such discussions should be then discussed at the level of ministers in order to receive a mandate to develop concrete proposals.

Let us consider the measures in order of their urgency and describe potential policy steps to be taken.

## 4.1. Negotiations

First, the negotiation arm has to be re-energized. There needs to be a strong new coalition (the Friends of the Doha Agenda) which substitutes for missing leadership in the negotiations. At this stage conclusion is more important than ambition, and similar to the development at the end of the Uruguay Round, extraordinary circumstances need out-of-the-box solutions. The DG should receive a special mandate to propose the contents (not just the contours) of the Doha package deal. A built-in agenda for a limited number of unresolved issues (analogous to the Uruguay Round) should be created to allow some form of flexibility for states (but opt-outs need to be limited) and future multilateral and plurilateral negotiation approaches for issue areas (that are excluded from the round) should therefore be defined. The package would consist of agreed commitments on selected areas and a detailed agenda of topics as well as the necessary process to be followed through alternative variable geometry approaches. This should also be done under the responsibility of the DG in consultation with the chairs of the key negotiation groups.

Second, and related to the grand bargain, a special committee is to be created that focuses on how best to design plurilateral approaches, both those following MFN logic and those that restrict MFN. Such a group should be composed jointly of Geneva-based and capital-based officials and one of the Deputy DGs should chair the committee. It should be limited to 20–25 participants reflecting the broad WTO membership, both in terms of regional representation and level of development. This committee should meet regularly, every second meeting being held in one of the main WTO member's capitals, and a small group of Secretariat officials should be asked to support the work.

For both initiatives to materialize, WTO members will need to show willingness and courage—without delegating some

tasks to both chairs of the negotiations and the DG progress is not possible.

## 4.2. Committee Work

Two things need to be done in order to improve further the functioning of committees. First, a review should be conducted by the WTO Secretariat under the supervision of the DG to make a factual assessment of the inner workings of the committees. Then, a group of independent academics should be appointed to carry out a survey of WTO members to collect systematically the views and opinions of those participating in various committee activities. Both types of information can provide the basis for an assessment of how well the different committees function and what can be done to improve the situation. The DG should then prepare a report for the attention of the WTO members for additional input.

Second, in light of the proposals outlined above, the DG would hold informal consultations with all the committee chairs before elaborating an action plan on how to move forward to increase the capacity of the committees. The findings would be presented to the entire WTO membership and discussed before the official start of a ministerial meeting to foster understanding and support from capital-based officials.

In the pilot phase, a group of independent experts would be invited to the meetings of some selected committees to support the chairs in the implementation of the proposals. After (a test period of) 12 months, another review conducted by a group of external experts involved in the committee work would be planned to take stock of the progress made and the possible wider application to more committees.

## 4.3. The Business Sector

In order to pursue the initiative to find common platforms of exchange between the ministers, the negotiators, and the business sector, large conferences should be organized both in Geneva and in universities worldwide where WTO chairs have been created. The purpose of the conferences would be to collect additional information on the exact needs of business actors for increased interaction and to share insights on existing practices. Government representatives could discuss potential best practices from their own perspectives. The conferences should also help business leaders to agree on the appropriate representation by business groups. The ICC and the World Economic Forum could jointly chair this process. Selection should take into account the type of business sector, the size of the companies (providing a strong representation of sectors characterized by small and medium-sized enterprises), as well as regional characteristics.

Following these bottom-up “caucuses,” the next step would be for the business sector to put forward a roster of representatives from which it could appoint up to 30 participants for the Business Advisory Council. The participants would serve on the council for a term of three years (non-renewable). Members of the BAC would be invited by the chairs of negotiation groups for informal gatherings and exchanges and would be encouraged to interact regularly with WTO ambassadors. There would also be two formal meetings a year at which the DG and the chairs of the committees represent the WTO membership. The chairs would informally share the content of the discussions with all members of the respective committee.

This proposal might only be feasible if the WTO membership also explores the possibility of a Civil Society Advisory Council that would have a similar function to that of the BAC.

Once the BAC is up and running, it could be tasked to organize the Business Forum to be held alongside the ministerial meetings.

In summary, the above institutionalized relations between the business sector and the WTO will only bear fruit if at the same time progress is made in negotiations and in the committee work.

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## Overview Paper and Think Pieces E15 Expert Group on the Functioning of the WTO

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The papers commissioned for the E15 Expert Group on the Functioning of the WTO can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status and Gap	How to Get There
<b>Improving the performance of the negotiation function</b>			
<b>1. Break the stalemate with a new grand bargain including major elements of the Doha Round and authorization for a defined set of non-MFN plurilaterals</b>	Short term	<ul style="list-style-type: none"> <li>– Greater inclusiveness less information asymmetry</li> <li>– Mismatch in expectations from the Doha Round</li> <li>– Most negotiations under the Doha Round have been deadlocked for a number of years</li> <li>– The notion of single undertaking is questioned</li> <li>– Enhanced focus on plurilateral approaches (e.g. TiSA, ITA II, EGA)</li> </ul>	<ul style="list-style-type: none"> <li>– Build a coalition of “friends of the Doha Round”</li> <li>– DG could receive a mandate to propose bridging solutions to close the Doha Round</li> <li>– Create a built-in agenda and define approaches for issues currently excluded from the Round</li> </ul>
<b>2. Create a committee or working group focusing on plurilaterals to monitor and guide, particularly when not MFN</b>	Short term		<ul style="list-style-type: none"> <li>– Establish a special committee made of 20-25 Geneva-based and capital-based officials chaired by one Deputy DG meeting both in Geneva and capitals focusing on how best to design plurilateral approaches (both inclusive and exclusive ones)</li> </ul>
<b>Strengthening the role and impact of committee work</b>			
<b>3. Strengthen the role of the Secretariat by:</b> <ul style="list-style-type: none"> <li>– Enhancing data management</li> <li>– Making more use of in-house expertise</li> </ul>	Short term	<ul style="list-style-type: none"> <li>– Dominance of WTO members keeps the Secretariat on the sidelines of negotiations</li> <li>– Unmet demand for surveillance of new development in trade policy (e.g. monitoring of protectionist measures)</li> <li>– Limited use of in-house expertise</li> </ul>	<ul style="list-style-type: none"> <li>– Enhance resources devoted to data compilation, statistics, and data management</li> <li>– Develop information portals/ creation of information hubs on regulatory matters</li> <li>– Chairs should be allowed to create <i>ad hoc</i> working groups chaired by Secretariat with members.</li> </ul>
<b>4. Improve leadership and coordination</b>	Short term	<ul style="list-style-type: none"> <li>– Limited attention paid to committee work</li> <li>– High rotation of chairs (one-year term)</li> <li>– Informal coordination among different committee chairs</li> </ul>	<ul style="list-style-type: none"> <li>– Initiate a review by the Secretariat under the supervision of the DG providing a factual assessment of the inner workings of the committees</li> <li>– Initiate an independent survey collecting the views of members about the functioning of the committees</li> </ul>
<b>5. Beyond compliance, improve the quality of exchange in committee work and create more space for deliberations</b>	Medium term	<ul style="list-style-type: none"> <li>– Current focus of committees remains on compliance with limited space to initiate a discussion on new challenges (e.g. climate change, exchange rate, food price volatility)</li> <li>– Limited use of external expertise (e.g. other IGOs)</li> <li>– Limited space for informal/ depoliticized debate</li> </ul>	<ul style="list-style-type: none"> <li>– Based on those reviews and a report by the DG, initiate informal consultations with all the committee chairs and elaborate an action plan to be approved by members</li> </ul>

Policy Option	Timescale	Current Status and Gap	How to Get There
<b>6. Improve the buy-in of domestic decision-makers</b>	Short term	<ul style="list-style-type: none"> <li>– Limited involvement of capital-based officials, non-trade ministries, or members of parliaments (MPs)</li> </ul>	<ul style="list-style-type: none"> <li>– Discuss trade policy review reports more broadly with domestic constituencies (e.g. different ministers, MPs).</li> </ul>
<b>7. Build bridges with the public</b>	Short term	<ul style="list-style-type: none"> <li>– Limited opportunities for targeted discussions with the wider public outside of Geneva</li> </ul>	<ul style="list-style-type: none"> <li>– Provide live coverage of certain WTO events</li> <li>– Allow for public debate when meetings take place outside Geneva</li> <li>– Invite online feedback on ongoing work</li> <li>– Allow written submission to certain committees by business/NGOs</li> </ul>
<b>Enhancing the involvement of the business sector</b>			
<b>8. Create a “Business Forum” at the margin of WTO ministerial meetings</b>	Short term	<ul style="list-style-type: none"> <li>– Willingness of private sector to invest time and resources in multilateral negotiations has partly shifted to regional negotiations</li> <li>– Current interaction though informal/formal processes at the domestic level and in an <i>ad hoc</i> manner at the WTO but no institutionalised mechanism for routine interaction at the WTO</li> </ul>	<ul style="list-style-type: none"> <li>– Replicate and perpetuate first experience of the Bali Business Forum organised in 2013 by ICC, the Evian Group and ICTSD</li> </ul>
<b>9. Create a Business Advisory Council to channel interaction between the private sector and the multilateral trading system</b>	Medium term		<ul style="list-style-type: none"> <li>– Convene a series of large conferences in Geneva and in universities where WTO chairs have been created, to collect information about business needs and discuss best practices (these could be chaired by the World Economic Forum or ICC)</li> <li>– Business to propose a roster of representatives from which to appoint 30 participants elected for three years</li> <li>– Establish similar process for a Civil Society Advisory Council</li> </ul>

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IMPROVING THE STATE  
OF THE WORLD

# Trade Governance Frameworks in a World of Global Value Chains

Policy Options Paper



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# Trade Governance Frameworks in a World of Global Value Chains

Sherry Stephenson

on behalf of the E15 Expert Group on Global Value Chains: Development Challenges and Policy Options

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Global Value Chains: Development Challenges and Policy Options. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Sherry Stephenson was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not necessarily been possible to do justice to the entire range of views expressed on this multidimensional topic. The policy recommendations therefore remain the responsibility of the author. The list of group members and E15 papers are referenced below.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve its effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

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- Agriculture and Food Security
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- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

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# Abstract

The nature of international economic interdependence and competition has undergone fundamental changes as a result of the emergence and operations of global and regional value chains. Today we live in a networked economy led by investment flows. Promoting a better understanding of GVC implications from a sustainable development and trade governance perspective has become a critical task. Global value chains are the product of globalization and particularly the lowering of transport costs and the information and communications technology revolution, whose advances have given firms the ability to efficiently unbundle their production processes across locations. GVCs, however, are not uniform in terms of governance or incentives. The implications of participating, or not, in a value chain will depend highly on their type and structure. Recent years have seen a slower pace of GVC expansion, which has been invoked as one of the structural causes behind the trade slowdown observed since the 2008 financial crisis. This does not mean, however, that

the potential for fragmentation is exhausted or that all sectors are affected equally. Following an overview of the emergence of GVCs and their implications for development and trade governance, the present paper identifies policy options to enable the efficient functioning of supply chains while promoting the sustainable participation of countries in these fragmented production networks. The first set of recommendations centres on options to inform the design of domestic policies for GVC integration and upgrading. They aim to contribute to a better understanding of the operation of GVCs, promote dialogue on their developmental dimensions and strengthen government capacities. The second set of options, of a more systemic nature, envisages possible steps towards a supply chain informed agenda for future trade negotiations. This focuses primarily on the WTO but also preferential trade agreements. The paper concludes with an outline of the sequencing in which the options could be applied and the process through which they could be carried forward.

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Abbreviations	
ECLAC	Economic Commission for Latin America and the Caribbean
FDI	foreign direct investment
G20	Group of Twenty major economies
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GVC	global value chain
ICT	information and communications technology
IDB	Inter-American Development Bank
ITA	Information Technology Agreement
ITC	International Trade Centre
LDC	least developed country
MNC	multinational corporation
OECD	Organisation for Economic Co-operation and Development
PTA	preferential trade agreement
RCEP	Regional Comprehensive Economic Partnership
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TFA	Trade Facilitation Agreement
TiSA	Trade in Services Agreement
TIVA	Trade in Value Added
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
WTO	World Trade Organization

# Executive Summary

Today we live in a globalized and networked economy led by investment flows. Global Value Chains (GVCs) involve a wide range of actors and institutions and span a broad number of trade and investment disciplines. This complexity has made GVCs a challenge for policy-makers. Promoting a better understanding of GVC implications from a sustainable development and international governance perspective is thus a critical task. As a contribution to this process, the E15 Expert Group, convened by ICTSD and the World Economic Forum in partnership with the Inter-American Development Bank, has examined the challenges and opportunities that the expansion and consolidation of GVCs has created for global trade governance and economic development. The outcome of this expert dialogue process is a set of forward-looking policy options presented herein.

## New Challenges

Global value chains are a product of trade policy reforms combined with the lowering of transport costs and the information technology revolution whose advances have given firms the ability to coordinate their production needs internationally. GVCs, often driven by the investment decisions of multinational corporations, typically involve a collection of firms located in different countries jointly forming a production line of upstream and downstream linkages. While GVCs allow firms to concentrate on specific tasks, they also increase interdependence. GVCs, moreover, are not uniform in terms of governance or incentives. The implications of participating (or not) in a value chain depend on their type and structure.

The international fragmentation of production is creating new opportunities for developing countries by eliminating the need to gain competency in all aspects of a particular good. Integration in GVCs is also frequently associated with enhanced foreign direct investment (FDI) and knowledge spillovers to the local economy. But these opportunities come with new challenges. First, existing evidence tends to show that most production networks are regionally oriented and concentrated around three hubs: North America, Europe and East Asia. This poses a challenge for developing countries located far away from industrial clusters. Second, trade policy, particularly preferential trade agreements (PTAs), plays an important role in shaping GVCs. While PTAs can create cost and regulatory incentives to source among members, strict rules of origin tend to disincentivize the use of cheaper inputs from third countries. Third, a major concern for developing country governments seeking to maximize benefits from GVC participation has been to capture domestically a higher share of value-added by moving up the chain.

Two important policy implications can be put forward. First, integration and upgrading in GVCs depends largely on domestic policy reform, and these policies go beyond narrowly defined trade policy instruments. For countries willing to use the “GVC technology” as an engine for development, an open import regime is important, minimizing trade frictions and improving connectivity are critical, and boosting absorptive capacities to generate dynamic benefits from FDI attraction is key. Second, in a globalized economy there will be international spillovers brought about by domestic policies or by the operation of value chains themselves. Such spillovers may include lead firms abusing dominant positions or they can result from competition between national incentive schemes designed to attract FDI.

Analysts generally concur that the current normative structure of many trade agreements may be insufficiently equipped to optimally respond to the reality of fragmented production networks. WTO rules still operate in vertical silos. A more integrated approach that considers the horizontal application of disciplines in various areas such as transparency, standards, competition, procurement and investment in both goods and services may offer an alternative approach to trade governance more in line with the world of networked production and trade.

In addition, the absence of a coherent set of multilateral disciplines on investment represents an increasingly glaring weakness in the international system. Other horizontal disciplines are also lacking, in particular relating to the movement of natural persons as well as competition policy. Meanwhile, major initiatives of a plurilateral nature, with potentially significant impacts on the development of GVCs, have been initiated. These include negotiations on the plurilateral Trade in Services Agreement and ambitious mega-regional schemes such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership.

## Policy Options

In view of these developments, the paper puts forward policy options for enhanced trade governance relevant to global value chains. The first set of recommendations centres on options to inform the design of domestic policies for GVC integration and upgrading. They aim to contribute to a better understanding of the operation of GVCs, promote dialogue and strengthen government capacities. The second set of policy options envisages possible steps towards a supply chain informed agenda for future trade negotiations.

### *Informing the design of domestic policies for GVC integration and upgrading*

Knowledge tools should be further developed and refined in order to promote a more empirical and sophisticated understanding of GVC operations in international trade. Trade in Value Added (TiVA) indicators should be expanded and could form the basis for closer collaboration between OECD-WTO, international organizations and development banks in analysing the impact of GVCs on trade and investment patterns.

An independent and neutral “Global Value Chain Development Platform” could be established and designed as a clearinghouse mechanism on the trade and development dimensions of GVCs and as a forum for policy dialogue. The platform could serve four functions: operate as a portal for research on the developmental impacts of GVCs; provide information to policy-makers on the operation of GVCs; identify barriers faced by firms in developing countries; and establish a worldwide network of developmental GVC experts.

Specific “supply chain councils” could be established to analyse supply chains in particular sectors. The councils, composed of private firms, trade officials and regulators, would be tasked with two main areas of work: carrying out mapping studies in specific production networks; and identifying its governance structure and the regulatory constraints.

Building on the above proposals, an option would be to convene a regular “Supply Chain Summit” bringing together governments and private sector actors to share experiences and analysis generated by the “GVC Development Platform” and the “supply chain councils.”

### *Towards a supply chain informed agenda for future trade negotiations*

A horizontal work programme on GVCs could be established in the WTO to explore areas where trade disciplines might be adjusted or further developed. This would help to focus discussions in the WTO on the system-wide set of issues surrounding the operation of supply chains from a trade policy governance perspective.

Another recommendation would be to explore the need for new international cooperative arrangements to address possible negative externalities or spillovers resulting from unilateral action and domestic policies that seek to foster GVC integration.

Finally, future trade negotiations should adopt a supply chain informed approach that integrates goods, services and investment under specific clusters of productive activities associated with a particular sector or value chain. The paradigm changes in world trade and investment brought about by supply chains and globally networked economies will need to be reflected in the adoption of a holistic approach to future rule-making.

## **Priorities and Next Steps**

The first set of policy options do not require any institutional changes in the WTO or other trade agreements but would contribute to the exchange of ideas around a structured agenda. The second set on a supply chain informed agenda imply changes in the way existing international negotiating fora work or undertake negotiations. These options of a more systemic nature could be aimed at over a longer time horizon.

### *Short-term options*

Developing and refining knowledge tools would require a commitment by organizations such as the WTO, OECD, UNCTAD, ITC, World Bank and regional development banks to expand the TiVA dataset, work with national authorities to develop input-output data, and develop regular reports on the functioning of GVCs. The creation of a “GVC Development Platform” is slightly more ambitious and would need to be driven by a consortium of policy research institutions or intergovernmental organizations (or a combination of both).

### *Medium-term options*

The “supply chain councils” could be led by trade analysts but should be primarily comprised of private firms whose input and business insights would be essential in mapping how the networking process operates in a particular sector. A consortium of intergovernmental organizations could establish and convene the “Supply Chain Summit.” The summit should obtain the buy-in and support from the private sector.

Regarding the second set of options, the first step to set in motion a supply chain informed agenda for future trade negotiations would consist in systematic and system-wide discussion in the WTO on the implications of GVCs for international trade governance through the creation of a work programme on value chains and development. The process would have to be initiated from inside and led by a group of interested WTO members.

### *Long-term options*

The options on new international cooperative arrangements and the adoption of a supply chain approach in negotiations are more ambitious and would require broad consensus among WTO members. Given the diversity of views, moving forward on a plurilateral basis may be a viable route. Alternatively, some countries may choose to use preferential agreements as a testing ground for new disciplines.

# 1. Introduction

The fragmentation of production processes through international supply chains, often referred to as global value chains (GVCs), is changing the nature of world trade and investment. As coordination and trade costs continue to fall, firms are increasingly outsourcing certain stages of their production in various locations. This has led to the formation of regional and global production networks, reflected in the importance of trade in intermediate goods and the foreign value-added content of exports. Today we live in a globalized networked economy led by investment flows. Business-to-business intermediate trade accounts for over two-thirds of the goods and nearly three-quarters of the services traded worldwide.

GVCs involve a wide range of actors and institutions, and span a broad number of trade and investment disciplines that have traditionally been treated in a fragmented manner. It is precisely this complexity and ubiquity that has made global value chains such a challenge for policy-makers. Yet, the importance of GVCs is likely to grow in the future with potentially significant implications for the way we design and implement trade and investment policies. Promoting a better understanding of GVC implications from a sustainable development and international governance perspective is therefore a critical task for policy-makers.

As a contribution to this process, the E15 Expert Group has examined the challenges and opportunities that the expansion and consolidation of global supply chains has created for global trade governance and development. The objective is to provide fresh and evidence-based thinking on critical issues facing the global trade system, and identify options to promote the effective integration and upgrading of countries in a global economy increasingly relying on GVCs.

What policies enhance opportunities or restrict possibilities in the operation of GVCs? How should individual countries at different levels of development position themselves to integrate into GVCs and maximise welfare gains? How can governments ensure effective international institutional and legal frameworks to manage growing economic interdependencies resulting from GVCs? What are the implications for future international trade negotiations at the regional or multilateral level? These are some of the questions addressed by the Group.

This paper is the authors' synthesis drawn from that examination. It is anchored in the broad considerations made by the Expert Group and builds on a series of think pieces and overview paper produced by members (referenced below). Section 2 summarizes the main points discussed by the Group with regards new issues raised by GVCs and section 3 builds on that analysis to focus on policy options. Section 4 then identifies in conclusion the next steps and provides a sequential timescale for implementation of the policy options.

# 2. Global Value Chains: The New Reality of International Trade

## 2.1. The Phenomenon of Global Value Chains

The phenomenon of GVCs is one of the manifestations of globalization. It is a product of the lowering of transport costs and the information and communications technology (ICT) revolution whose advances have given firms the ability to co-ordinate their production needs on a real-time basis, no matter what the geographical location of the producer. A GVC usually involves a collection of firms located in different countries and jointly forming a production line. Depending on the location of a firm in a production network, participation may either involve forward linkages—where a firm produces an output that is used in production for export in another nation—or backward linkages where a firm uses imported parts or components used as input into production that is exported (Hoekman 2015). While GVCs permit enterprises in different locations to concentrate on specific tasks and activities without having to worry about producing the final good and marketing it, they also increase interdependence. Each link in the chain relies on upstream producers delivering their output on time and meeting the required quality and safety standards. As firms unbundle their production processes, logistics costs and efficient border operations therefore become crucial. This includes all aspects of clearance procedures, port operations, cargo handlers, storage facilities, as well as transport and trade-related infrastructure. Services also play a key role in the operation of international production networks, especially transport, communications, and other business services—the fastest-growing component of world trade. Services are both embodied and embedded activities along the whole gamut of the value chain for manufactured, agricultural, and natural resource products, as well as for other services activities.

GVCs are essentially driven by investment decisions of multinational corporations (MNCs), through their outsourcing and offshoring activities. The main motivation of the lead firm, in a context of globalized output, is usually to reduce its transaction costs and lower its risks. Yet GVCs are not uniform. Some are created by research-driven companies looking for high research value-added. Others are propelled by marketing-driven companies looking to source inputs in low-cost locations or by resource-seeking investment focusing on extractive industries and securing access to raw material. This in turn affects the structure of the value chain: its governance and opportunities for outsourcing. Overall, as described by Draper and Freytag (2014), not all GVCs are created equal and the implications of participating (or not) in a value chain depend highly on the type and structure of the supply chain.

GVCs are not static either. The 1990s witnessed in a surge in trade in parts and components for the reasons outlined above. In the 2000s, however, this process decelerated with the average share of intermediate goods in world non-fuel exports stagnating at around 50%. This slower pace of GVC expansion has in fact been invoked as one of the structural causes behind the trade slowdown observed since the 2008 financial crisis (Hoekman 2015b). In China, the share of imports of parts and components in total exports declined from its peak in the mid-1990s of 55% to a current 35%, implying a diminished fragmentation of the production process. China also appears to have gradually generated a higher share of domestic value addition and reduced its dependence on foreign produced inputs across a range of industries (Francis and Morel 2015).

Another explanation for this deceleration lies in the need to create efficiency gains and rationalize the cost of managing highly fragmented value chains by consolidating or grouping intra-regional chains. This does not mean, however, that the potential for fragmentation is exhausted or that all sectors are affected equally. The slowdown in vertical specialization seems to have affected particularly the manufacturing sector and much less services where fragmentation is only beginning to occur. In a similar vein, ICT innovation might well result in further incentives for specialization in the future.

## 2.2. The Development Dimension of Global Value Chain Participation

Many GVC analysts are of the opinion that the international fragmentation of production is creating new opportunities for developing countries by eliminating the need to gain competency in all aspects of a particular good and allowing enterprises to concentrate on one or a few specific stages of the production line. This type of specialization offers opportunities for firms, including smallholder farmers, small and medium-sized enterprises (SMEs) providing specific inputs, as well as service and logistics providers, to participate in the international division of labour. Furthermore, integration in global supply chains is frequently associated with enhanced foreign direct investment (FDI), technology transfer and upgrading, knowledge spillovers from global firms to local suppliers, and higher economic growth (Estevadeordal et al. 2013). But these opportunities come with new challenges.

### 2.2.1. Are global value chains really global?

GVCs have not spread evenly across the world. They tend to concentrate around what Baldwin (2012) calls “Factory North America” centred on the United States; “Factory Europe” centred primarily on Germany; and “Factory Asia” centred on Japan. This is not to suggest the absence of truly global supply chains, but existing evidence tends to support the claim that the majority of international production networks are regionally oriented. This regional bias stems partly from transport and logistic costs that discourage value chains spanning long distances. Firms will only unbundle their production as long as the saved costs arising from the fragmentation process compensate for the additional cost of coordinating remotely located production and the cost of moving inputs across borders (Hoekman 2015).

This reality poses a challenge for countries located far away from industrial clusters even if the quality of logistics can compensate for the cost associated with long distance travel. In this respect, Estevadeordal et al. (2013) point to the fact that many developing countries, notably in Africa and Latin America, have remained on the sidelines of cross-border production sharing. Draper and Freytag (2014), argue however that the geography of GVCs is not written in stone. In recent decades, China has served as the key location for processing and assembling of manufactured goods. But as Chinese labour costs increase, production has started to relocate to other countries—e.g. Vietnam, Cambodia or Mexico. This trend could present opportunities for other developing countries, including in Africa where costs are likely to be lower than in emerging economies.

### 2.2.2. The role of trade policy in shaping global value chains

Beyond distance, trade policy also plays a role in shaping GVCs. This is particularly the case for preferential trade agreements (PTAs) formed among neighbouring countries (Estevadeordal et al. 2013). The fact that trading across borders in the same PTA does not add extra duties creates an incentive to source part of the production process from countries that have formed a PTA. More specifically, Estevadeordal et al. estimate, after controlling for the effect of distance, that, on average, countries will source 15% more of their foreign value-added from members of the same PTA than from non-members. For Aldonas (2013), PTAs that have gone beyond the WTO to embrace deeper trade-related disciplines, in areas such as procurement, investment, competition policy, standards and intellectual property rights, have been able to set conditions of competition that have allowed firms to operate within a networked global economy.

However, PTAs also have limitations, not least because strict rules of origin tend to disincentivize the use of cheaper parts and materials from third countries. While being a member of a trade agreement does not necessarily impede a country from developing supply chains with non-member countries, rules of origin have significant implications in the way firms choose the location in which they fragment production, typically restricting outsourcing from countries

with which they share a PTA. In this context, Estevadeordal et al. (2013) underline the current suboptimal functioning of GVCs and the potential to increase efficiency through multilateral solutions or, alternatively, more flexible rules of origin. Preliminary evidence suggests, for example, that instruments like diagonal cumulation across PTAs—that allow for cumulation with third parties with which both trading partners have PTAs in force—can be quite effective in reducing the strictness of rules of origin and in spurring cross-border production sharing among PTA members.

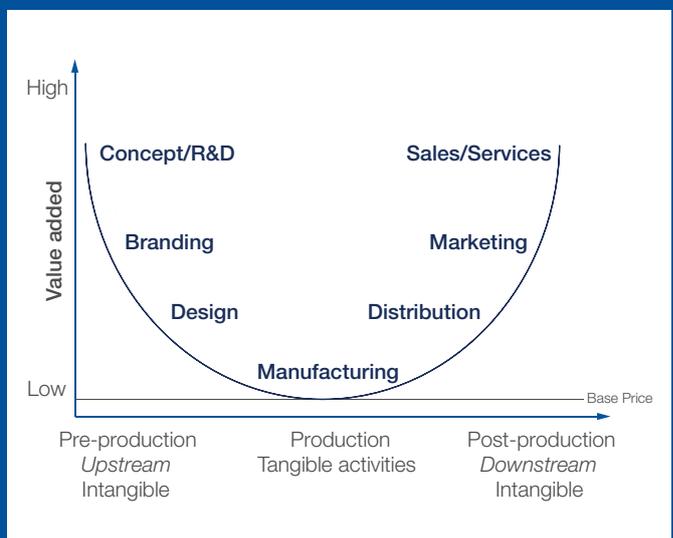
### 2.2.3. Maximizing the gains from value chain participation

For developing country governments seeking to maximize benefits from value chain participation, a major concern has been to capture domestically a higher share of value-added in existing chains to promote objectives such as enhanced productivity, the deployment of new technologies, increased employment, and more diversified and resilient economies (see Box 1). Achieving these objectives is not automatic. As highlighted above, GVCs tend to be led by large multinational companies that decide where to locate plants, where to invest and who to source from based on their strategy to maximize profits. This may or may not offer participatory or upgrading opportunities for particular countries (Low and Tijaja 2013).

#### Box 1: Moving up the Value Chain

From a development perspective, a major challenge often associated with participation in global value chains consists in moving progressively to higher value-added segments of the chain through upgrading or by engaging with other supply chains. This concern is best illustrated by the famous “smiling” curve developed by Stan Shih. Using the information technology industry as an example, the curve shows how higher value-added segments of the chain tend to be either upstream or downstream while manufacturing and assembling—the stage at which most developing countries enter the value chain—often result in comparatively lower value addition.

Figure 1: Stan Shih’s Smiling Curve



Source: adapted from Stan Shih (1992)

Some policy-makers and analysts have stressed the need for active policies to promote development outcomes through GVC integration and upgrading. Draper and Freytag (2014) highlight some of the main arguments developed by these proponents. They argue that central to the critique is a certain scepticism about the purported benefits of foreign direct investment by MNCs for host countries, and hence the need for industrial policy to secure development outcomes from such investments.

More specifically, in the absence of backward linkages with the rest of the economy, critics point to the footloose nature of efficiency-seeking investments, especially those operating in the lower value part of the value chains (e.g. clothing industry), which are constantly looking for cost savings and are willing to relocate rapidly. Critics also caution against the risk for resource exporting countries of being caught in the “resource trap” when the main purpose of FDI is to extract natural resources with limited incentives to invest in ancillary activities. Others suggest that in the absence of active policies, low- and middle-income countries often lack sufficient absorptive capacity to effectively benefit from technology upgrading as a result of GVC integration. Finally, some are concerned about a possible race to the bottom as countries compete to attract FDI by providing generous incentive packages such as tax holidays or even by eliminating regulatory requirements (e.g. environment, labour, safety).

### Box 2: Global Value Chains and Industrial Policies

For Low and Tijaja (2013), industrial policies can be broadly or narrowly focused. Broad-based or horizontal policies are targeted at removing inefficiencies and dead-weight losses, thereby creating competitiveness. These may include streamlining administrative procedures, lowering the costs of doing business, strengthening institutions, investing in human capital or developing infrastructure. By nature, these policies tend to have economy-wide implications and carry fewer risks in terms of unforeseen consequences in policy-induced relative price relationships. Industry-specific policies, on the other hand, seek to change incentive structures and stimulate activities in particular areas. A typical justification for such policies is the need to address market failures that result in resource misallocation. In a value chain world, Hoekman (2015) argues that there may be additional efficiency reasons for governments to intervene in a targeted manner—e.g. to address information or coordination failure—and that such interventions could benefit the chain as a whole, including foreign plants, their workers and local communities.

A major argument of those opposing industry-specific policies is that government failures more often than not substitute for market failures and may end up generating adverse effects. For Draper and Freytag (2014) however, recent approaches to industrial policies tend to be more sophisticated than those prevailing in the 1960s and 1970s in which crude import substitution combined with “picking the winner” tended to deliver poor outcomes. Central to them is the notion of “deliberative targeting” or “self-discovery” in which governments and industry participate in an iterative process aimed at identifying revealed comparative advantages as well as bottlenecks or binding constraints that block industrial development.

Addressing these concerns requires effective policy design. Innovation is key here, together with the ability to adapt to rapidly changing demand. Starting from existing domestic value chains is critical. But policies also need to take into account a wide range of country variables such as: its geographical location; its position as a resource or industrial goods or services exporter; the type of FDI it is able to attract; and at what point along a supply chain does its firms provide inputs into the network—upstream or downstream. Finally, in addition to broader horizontal policies, some analysts argue that there is likely to be a need for very specific types of government interventions to address market failures of different kinds.

## 2.3 Domestic Policies and International Governance Frameworks

Two main policy implications can be drawn from this discussion. First, integration and upgrading in GVCs depends largely on domestic policy reform, and these policies go beyond narrowly defined trade policy instruments. The quality of institutions and trade infrastructure, the level of education, the incentives in place for investors and firms operating in the local economy, and the level of corruption all play a role in investment and sourcing decisions in GVCs. Furthermore, policy in a supply chain world is more complex than in one where trade is of a “ship and forget nature” and where traded goods are produced using only local factors of production (Hoekman 2015). For countries willing to use the “GVC technology” as an engine for development, an open and predictable import regime becomes more important, particularly for intermediate goods, as competitiveness is increasingly defined by both country imports and exports. Minimizing trade frictions such as delays in border clearance or low quality distribution facilities is critical. Another key factor is connectivity, including transport, logistics services, and information and communications technology (ICT) networks. From an FDI attraction perspective, policies have to address constraints that impede FDI entry while targeting, at the same time, first tier suppliers of lead firms and providing support for the creation of backward linkages.

All this calls for more effective strategic collaboration between governments and the private sector. It also accentuates the importance of government capabilities for policy effectiveness. The World Bank and the regional development banks have a critical role to play in this regard, and they are actively working to help developing countries address these challenges. The Aid for Trade process can also be instrumental in helping to leverage assistance for needed GVC-induced reforms, through the formation of better linkages between domestic reforms and capacity building in trade.

Second, although the agenda for GVCs is largely a unilateral one, in a globalized economy there will be negative externalities, or international spillovers, brought about by domestic policies or by the operation of value chains themselves. Such spillovers may include lead firms abusing dominant positions and thus extracting a disproportionate amount of the profits from GVC operation, or they can result from competition between national

incentive schemes (e.g. subsidies) designed to attract FDI, ultimately leading to a race to the bottom. Addressing these concerns calls for international cooperation. International governance frameworks can play a vital role in managing growing economic interdependencies resulting from GVCs by establishing a fair, transparent and predictable trade environment.

#### 2.4. Are Existing Trade and Investment Regulatory Frameworks up to the Task?

Existing international disciplines on trade and investment provide the foundations on which GVCs have developed. Granted, with the expansion of supply chain trade, in conjunction with associated flows of FDI, incentives to use traditional trade policy instruments like tariffs are decreasing. But tariff barriers are only one of a number of factors determining transaction costs for firms and are often low in comparison to other issues that inhibit participation of firms in GVCs. Today, international trade and investment policy frameworks at the multilateral and regional level increasingly touch upon a much broader set of rules and disciplines ranging from standards, to intellectual property, services, subsidies, government procurement and investment. Assessing the extent to which existing frameworks are adequate to respond to the reality of GVCs, while providing opportunities for participation and upgrading, is a central question.

In this area, the relevance of PTA and WTO work in a wide range of areas can be highlighted (see Box 3). However, analysts generally concur that the current normative structure of many trade agreements may be insufficiently equipped to optimally respond to the reality of fragmented production networks.

#### Box 3: Selected WTO Initiatives and their Relevance to GVCs

Besides ongoing negotiations under the Doha Round or regular committee work in areas such as on non-tariff measures including technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) standards, several recent initiatives at the WTO are likely to have a direct bearing on GVCs. Some of them are briefly listed here for illustrative purposes.

##### *Trade Facilitation Agreement*

Supply chains do not exist without efficient logistics. The WTO has not negotiated a “full logistics” package that would cover transport costs, ICT services, customs clearance procedures and all aspects of border management. However, the Trade Facilitation Agreement (TFA), approved by WTO Trade Ministers at the Bali Ministerial Conference in December 2013, contains important provisions for more efficient customs and importing procedures, together with provisions for technical assistance and capacity building in this area. Full implementation of the TFA could generate sizable gains to the world economy, and will serve to make trade flows, including through GVCs, operate more efficiently.

##### *Information Technology Agreement (ITA II)*

Given the importance of information technology in the operation of supply chains, the recently completed expansion of the Information Technology Agreement’s product coverage under the ITA II is a welcome step that should assist in the smooth operation of GVCs. Low-cost ICT goods are essential for an efficient communications sector, which is one of the main channels through which services tasks are inputted into global value chains. Efficient ICT infrastructure and services enable the existence and operation of globalized production networks.

##### *Duty-Free and Quota-Free Market Access and Rules of Origin*

The cost of protection in a globalized world of interdependent production and trade is high. Tariffs impact not only final goods but also intermediate inputs that can be key components of production elsewhere, thus magnifying their negative effects. In this context, extending duty-free and quota-free treatment for goods and services to least-developed countries (LDCs) would facilitate their ability to supply “inputs” or “tasks” to global value chains. In the same vein, efforts to operationalize the services waiver by granting LDC services and service providers effective preferences could facilitate the integration of LDCs in global supply chains. Finally, as highlighted above, simplifying rules of origin and making them more flexible by inter alia allowing for cumulation across PTAs could have a significant impact in improving the optimal functioning of GVCs.

##### *Aid for Trade*

Given that the bulk of relevant policies regarding global value chains are domestic in nature and involve infrastructure improvements, institutional strengthening and human capital formation, the Aid for Trade initiative launched in 2005 could help support the achievement of domestic objectives that best serve heightened competitiveness in developing countries and LDCs by targeting policy weaknesses that impede their participation in GVCs. A mechanism to better tie the objectives of achieving more competitive markets with a focus on areas that contribute most to reducing trade costs, as suggested by Hoekman (2014), would be beneficial to increase the competitiveness of low-income and developing countries and, in a corollary fashion, their ability to draw potential benefit from greater participation in GVCs. This would include, in particular, measures targeted toward: regulatory reforms in service sectors so as to improve the quality of service inputs; reducing the trade-impeding effects of non-tariff measures; and institutional strengthening for trade facilitation and border management. Such a discussion could be initiated within the annual Aid for Trade Review.

#### 2.4.1. A multilateral system that operates in vertical silos

At the broadest level, WTO rules still operate in vertical silos—with parallel and dissimilar rules for goods, services and intellectual property—linked only by the organization’s institutional framework and its dispute settlement mechanism. Such policy fragmentation no longer corresponds to the way in which trade and investment happens in a GVC world. A more integrated approach that considers the horizontal application of disciplines in various areas such as transparency, standards, competition, procurement and investment in both goods and services may offer an alternative approach to trade governance more in line with the world of networked production and trade.

In this respect, services play a centrally important role in the operation of global value chains. The process of “servicification” has become widespread in the world economy and has seen firms produce and embed an increasing amount of services in their products. Services now account for the majority of trade in intermediate products, 60% of world FDI flows, and nearly half of world trade on a value-added basis. Services make the operation of GVCs possible by allowing for various production nodes to be connected in a seamless manner. The integration of services and goods in GVCs has yet to be properly articulated in trade policy discussions and negotiations, a fact highlighted by Hoekman (2014).

Breaking down such silos in the future to move towards an integrated governance approach for trade would appear desirable as a long-term objective. In the meantime, however, more holistic policy discussions within existing bodies and the incorporation of more systematic and comprehensive supply chain analysis in WTO publications, including through its annual reports, would help in broadening the understanding of GVC dynamics and contribute to better overall policy awareness.

#### 2.4.2. Are there missing pieces in the puzzle?

For many experts, the absence of a coherent set of multilateral disciplines on investment and investment incentives represents an increasingly glaring weakness in the international system. Foreign direct investment flows are a powerful driver of world trade in the 21<sup>st</sup> century and a major determinant of the operation of supply chains. The fragmented governance of FDI hinders the ability to tackle impediments and distortions affecting investment, while also fuelling competition between governments to attract investment through a variety of incentives such as

tax exemptions or relaxed regulations ultimately leading to a race to the bottom. Likewise, other important horizontal disciplines are at present lacking, in particular those relating to the movement of natural persons as well as competition law and policy. The latter is important as it disciplines the behaviour of key firms, particularly large multinational corporations in their worldwide operations, thus providing protection from market abuse and domination for firms from smaller economies, including those that participate in GVCs.

Meanwhile, initiatives of a plurilateral nature have been initiated and are moving forward within and beyond the WTO. The Trade in Services Agreement (TiSA) negotiations have been ongoing since 2013 among 28 countries accounting collectively for nearly 70% of world services trade. The objective is to reach a plurilateral agreement containing more open market access commitments, enhanced disciplines in the WTO General Agreement on Trade in Services (GATS), and a larger number of sectors with specific regulatory obligations including new issues such as cross-border data flows, regulatory coherence and disciplines on state-owned enterprises. In a similar vein, new mega-regional negotiations such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) and the Regional Comprehensive Economic Partnership (RCEP) represent ambitious attempts to move towards economic integration at a far greater scale than previous initiatives, with potentially significant impacts on the development of GVCs.

For Hoekman (2014) and Draper and Freytag (2014), groups of countries with shared interests in enhanced trade governance should be able to advance these trade initiatives on a plurilateral or regional basis. If done outside the WTO, a “linking” mechanism could be explored that would allow the WTO to extend on a most-favoured-nation basis some of the new disciplines and market opening commitments emerging from new plurilateral agreements relevant to the operation of GVCs. Another option would be to allow WTO members willing to sign into the agreement to do so and apply it among signatories, as in the case of the WTO plurilateral agreements on government procurement and information technology. Countries wishing to apply this broader focus of trade rules should be able to do so by choice when they feel that it is appropriate for their economies.

# 3. Policy Options for Enhanced Trade Governance Relevant to Global Value Chains

Based on the considerations highlighted above, this section outlines various policy options with the purpose of promoting the effective integration and upgrading of countries in a global economy increasingly relying on GVCs. These policy options fall into two broad categories and cover different time frames.

The first set of recommendations centres on short and medium-term options to inform the design of domestic policies for GVC integration and upgrading. These do not require any institutional changes in the WTO or other trade agreements but would contribute to a better understanding of the operation of global value chains in the context of international trade and strengthen the capacity of governments to design effective domestic policies. The second set of policy options envisages possible steps in the medium and longer-term towards a supply chain informed agenda for future trade negotiations focusing on the WTO as well as negotiations in the context of mega-regional trade agreements and other PTAs.

## 3.1. Informing the Design of Domestic Policies for GVC Integration and Upgrading

### 3.1.1. Policy option 1: Develop and refine knowledge tools

This option aims at promoting a more empirical and sophisticated understanding of GVC operations in international trade by further developing and refining knowledge tools.

The WTO has already taken some important steps in this regard, beginning with the publication of a seminal report in 2011, together with IDE-JETRO, entitled “Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks,” which focused on the factors that helped shape global production patterns. The report coined the phrase “made in the world.” The WTO has also actively collaborated with the OECD to create the Trade in Value Added (TiVA) database, released in 2013, which allows governments and analysts to better understand trade linkages in an interdependent globalized economy and the real value-added that various countries actually generate in trade flows (OECD-WTO 2013). Other international institutions such as UNCTAD, the International Trade Centre, the World Bank, regional development banks and several think tanks are also generating empirical analysis. However, this still happens on an *ad hoc* and partial basis.

To further refine existing knowledge tools, the TiVA database should be continued on a permanent basis, expanding its coverage, when possible, to additional WTO members, industries and more recent years. To promote evidence-based GVC policy analysis, the two organizations, in partnership with other institutions and the international statistical community in general, should support efforts to develop and improve the quality of national supply-use (input-output) data and trade statistics, particularly in smaller developing countries. Extensions should also consider the aggregation of firms that better reflect “made in the world” production as well as linking TiVA to FDI flows. This may help to provide new insights on the policy sustainability of trade and development strategies.

These extensions could form the basis of closer collaboration between the WTO/OECD and UNCTAD, ECLAC, UNESCAP, the World Bank and regional development banks in analysing the impact of GVCs on trade patterns, the importance of trade in value-added terms and the role of FDI in GVCs. It would allow for the cementing of ongoing collaborations such as the joint reports prepared for the G20 Summits in 2013 and 2014. The relevant international or regional organizations should also be encouraged to team-up in launching a more regular joint publication on value-added trade, with corresponding analysis based on the context of the TiVA database, to encourage further analysis by policy-making and research communities on GVCs. Different countries, sectors, firm types and regions could be featured in this regular analysis

In addition to the above meta-approach, international organizations, think tanks and research institutions could collaborate with national statistical authorities to produce sufficient detail for supply-use tables together with trade by enterprise characteristics (e.g. size class, ownership). This would allow for a more complete analysis of firm heterogeneity and trade involvement for both goods and services. Incorporating GVC perspectives into the country analyses of other think tanks and international organizations as has been done by the World Bank, the OECD and several regional development banks, would also be a useful support to expanded international focus on the operation of supply chains and their implications.

Finally, in order to permeate thinking about a networked world of production and trade, the WTO Annual Report

could feature a discussion of the latest developments in supply chain activity, along the lines of that presented in the WTO World Trade Report of 2013. These discussions could emphasize the growing trade in intermediates associated with expanding production networks and the linkages between economies at all levels (trade, FDI, labour mobility, etc.) as well as the implications of GVCs for trade policy formulation. A supply chain perspective could be included in WTO research reports and, where possible, in the work of WTO councils and other bodies. In a similar vein, interested developing countries could engage in a collaborative reflection on the role of GVCs in their economies through the Trade Policy Review Mechanism.

### 3.1.2. Policy option 2: Establish an independent GVC development platform

An independent and neutral “Global Value Chain Development Platform” could be established and designed as a clearinghouse mechanism on the trade and development dimensions of GVCs. The platform could also operate as a forum for policy dialogue.

Given the need to address the uneven participation of countries in GVCs, a “Global Value Chain Development Platform” could be created outside of trade governance frameworks. It could be based in an independent organization(s) and coordinated by dedicated institutions. The latter could host relevant policy research initiatives on GVCs, document their developmental implications, and develop and refine relevant metrics of GVC policy analysis. Currently there is no GVC platform gathering insights on how GVCs may offer a path to economic development and what type of developmental benefits might be gained from participating in these networks—with a view to assisting awareness and adoption of relevant strategies on the part of developing country officials.

A GVC platform as presented above could serve four functions:

- Create a portal for all relevant policy research on the developmental impacts of global value chains;
- Provide information to developing country policy-makers and interested stakeholders on the operation of global value chains and their trade and development implications, so as to assist them in formulating appropriate strategies that will maximize the developmental benefits of participating in such networks;
- Identify barriers faced by firms in developing countries that impede their participation and upgrading in value chains, particularly for SMEs; and
- Establish a worldwide network of developmental GVC experts and provide a forum where ideas can be exchanged, comparative scholarship reviewed and advice provided.<sup>1</sup>

Although considerable research has been devoted of late to GVCs, a review of existing platforms and websites reveals that there is no focal point that addresses the concerns that many developing countries harbour about the operations of GVCs, their developmental implications, and the ways in which they might best benefit from participating in globalized production networks, as well as how they might upgrade within them once they have gained a foothold. This is particularly pertinent for SMEs in developing countries that face a number of hurdles in trying to penetrate GVC networks for various reasons, as well as for developing country governments trying to design the most effective policies to facilitate the greater participation of their firms in GVCs.

The policy objective of the platform would be to identify and generate objective information and research that would explore the developmental implications of global value chains. The information contained in the platform could serve the interests of developing country policy-makers with respect to the most appropriate policies to be adopted at the national and regional levels, including trade and investment policies, which would assist the insertion and upgrading of their firms into global production networks. Such information could also assist developing country officials in their participation in the negotiation and operation of regional trade agreements, as well as in the formulation of their national development strategies and the execution of their policy agendas.

The information hosted by the platform could also be fed into the various regional integration processes, the deliberations of the development community, Aid for Trade strategies and donor assistance decisions. It could thus facilitate the meeting of minds and joint discussions of the trade and the development communities. Online discussions and training could be organized on the platform, which would bring together analysts on the developmental aspects of GVCs and interested government officials.

### 3.1.3. Policy option 3: Establish specific supply chain councils

Specific “supply chain councils” could be established to map supply chains in particular sectors, identify inputs used and where they are sourced, and describe the most binding regulatory policy constraints affecting their functioning.

The private sector plays a key role in the operation of supply chains and there is a need for governments and policy-makers to better understand exactly how supply chains operate in practice. The creation of “supply chain councils” could serve thus purpose, along the lines

<sup>1</sup> In the line of this policy recommendation, it is of note that a new Research Center for Global Value Chains (RCGVC) is currently being established in Beijing, China, under the initiative of the Chinese Government. It will be dedicated to research and analysis of GVCs from a developmental perspective and will enjoy the institutional collaboration of many international organizations, think tanks, and universities from around the world in this effort. The Center will begin operations in 2016.

proposed by Hoekman (2013). These councils could focus on a selected number of specific production networks and would be composed of private sector firms, trade officials and regulators working within the sector in question. The councils would be tasked with two main areas of work:

- Carrying out mapping studies of the supply chains in specific production networks, identifying inputs used and locations from where they are sourced, as well as the “bundling” of inputs involved in the production process; and
- Identifying the functioning of the GVC, its governance structure and most binding regulatory policy constraints that impact the operation of the supply chain in question.

This initiative could help move beyond the current *ad hoc* and often superficial analysis of the functioning of specific value chains, while promoting a better understanding in policy circles of the constraints faced by the private sector, particularly in developing countries. The implementation of mapping studies within the “supply chain councils” would allow firms to lend their expertise to help policy-makers concretely understand how the fragmentation of production is taking place in practice. The results of these mapping studies could feed into discussions in various policy contexts, both internationally and domestically.

#### 3.1.4. Policy option 4: Convene a regular supply chain summit

Another option to consider, which feeds on the above proposals, would be to convene a regular supply chain summit bringing together governments and private sector actors to share experiences and analysis generated by the “GVC Development Platform” and the “supply chain councils.”

Given the limited space for dialogue and experience sharing on GVC functioning, as well as the manner in which developing countries can promote entry and upgrading in supply chains, the WTO, together with a consortium of interested international organizations including UNCTAD, the World Bank and regional development banks, could organize a regular “Supply Chain Summit.” The summit could usefully focus on issues involving GVCs. Topics of discussion could include: the regulatory policy constraints affecting GVC operations; the developmental implications of GVCs; and how to enhance developmental objectives through steps to induce a more inclusive operation of GVCs and a more equal distribution of gains. The information assembled by the GVC Development Platform would usefully serve to provide content and focus for such discussions. The summit could direct relevant councils within the WTO to work together in a WTO-wide and horizontal working group that would coordinate input into the Aid for Trade process.

## 3.2. Towards a Supply Chain Informed Agenda for Future Trade Negotiations

### 3.2.1. Policy option 5: Establish a horizontal work programme in the WTO

A horizontal work programme on GVCs could be established in the WTO to explore areas where international trade disciplines might be adjusted or further developed.

A work programme on global value chains could be created within the WTO, similar to the work programme on electronic commerce, which would help to focus discussions in the WTO on the system-wide set of issues surrounding the operation of supply chains from a trade policy governance perspective. The GVC work programme could be taken forward on a horizontal basis and embedded into the work of all WTO councils (goods, services and intellectual property) as well as the Committee on Trade and Development. As a precedent, the WTO work programme on small, vulnerable economies already includes a discussion of GVCs. This could be broadened.

The creation of an institution-wide work programme on global value chains would help break down the walls between the silos of WTO disciplines by carrying out discussions under a horizontal supply chain lens. It would provide a space to discuss a broad range of issues such as non-tariff measures, rules of origin, services, trade facilitation and subsidies to list but a few. All WTO bodies involved could be required to report on their GVC discussions every two years. If launching an institution-wide work programme on GVCs is not feasible, then alternatively the WTO Council for Trade in Services and/ or the Council for Trade in Goods and/or the Committee on Trade and Development should take up such a suggestion based on an initiative from one or more interested WTO members.

### 3.2.2. Policy option 6: Explore new international cooperative arrangements

Another recommendation would be to explore the need for international cooperative arrangements to address possible negative externalities or spillovers resulting from unilateral action and domestic policies that seek to foster GVC integration.

Current WTO disciplines were not designed to respond to today’s realities and are not necessarily in line with the constraints faced by the new organization of production and trade. Similarly there may be a need to address possible negative externalities or spillovers resulting from domestic policies that seek to foster GVC integration. Several of the policy areas that impact GVC functioning are at present outside of the WTO ambit. These include, among others, competition policy, electronic commerce, data transfers, and localization requirements. In other areas of critical importance to GVCs, such as the movement of natural persons, existing commitments are at most embryonic. Investment is an area that strongly impacts on GVC decisions and operations as GVCs have been driven by cross-border investment activity. Currently, investment governance is fragmented and overlapping with little overall

coherence in rule-design or implementation. Different forms of regulatory impediments affecting investment are one of the main barriers relevant to the operation of GVCs. At the same time, the risk of a race to the bottom resulting from unilateral investment incentives should not be underestimated. Likewise, competition policy can have an impact on the benefits that developing countries are able to derive from GVCs. At present there are no multilateral disciplines in this area.

In this context, it might be advisable for the system to undertake a “reality check” exercise by reviewing existing disciplines while exploring the need and rationale for further international cooperative arrangements, without pre-empting the result of such an exercise. The main objective should be to ensure that the system has effective international institutional and legal frameworks to manage growing economic interdependencies resulting from GVCs.

### 3.2.3. Policy option 7: Adopt a supply chain informed approach in negotiations

Future trade negotiations should adopt a supply chain informed approach that integrates goods, services and investment under specific clusters of productive activities associated with a particular sector or value chain.

It is difficult to predict when members of the world trading system may be ready for the next round of multilateral trade negotiations, given the difficulties confronted in completing the Doha Round. However, if and when this time comes, the paradigm changes in world trade brought about by supply chains and globally networked economies will necessarily need to be reflected in negotiating approaches, rules and outcomes. Frictions to the smooth functioning of trade at the borders identified in the implementation of the Trade Facilitation Agreement, approved at the WTO 9<sup>th</sup> Ministerial Conference, will help to underscore the importance of logistics in supply chain operations. The impact of the TFA should be leveraged to support the adoption of a holistic approach to future rule-making. However, many of the essential policies for supply chain operation lie outside the scope of the TFA.

Should a new round of multilateral trade negotiations be initiated at some point in the future, WTO members should adopt a supply chain informed approach, negotiating issues or sectors in relevant clusters of associated networked activities. The standard GATT/WTO approach of negotiating separately on goods and services should be reconsidered, and the areas relevant to the operation of a given global value chain should be treated as much as possible under a holistic and horizontal approach. Adopting a supply chain approach to trade negotiations would imply negotiating disciplines for goods, services and investment with respect to a cluster of productive activities associated with particular supply chains rather than with specific sectors. As Aldonas (2013) suggests, this could be applied, for example, to agri-food value chains as a possible cluster. Negotiating in clusters has not been attempted on a significant scale in the WTO or in other negotiating fora, but arguably represents a promising route for adapting global trade and investment governance to a world characterized by GVCs.

# 4. Next Steps and Priorities

The first set of policy options (1 to 4) concerns awareness building, capacity building and the promotion of a purposeful dialogue on the development dimensions of GVC integration and upgrading. These recommendations will not only enhance transparency but also serve as a platform for the exchange of ideas, experiences and good practices around a structured agenda to deepen the discussion—moving sector-by-sector and issue-by-issue, including on highly technical issues. Ultimately, such a process could lead to the identification of priorities for action and governance reform. These options will not require any institutional changes in the WTO or other trade agreements and could be carried forward within a short to medium-term time horizon under the leadership of international institutions.

Specifically, policy option 1 on knowledge tools would require a commitment by relevant international organizations such as the WTO, OECD, UNCTAD, ITC, World Bank and regional banks to expand the TIVA dataset, work with national authorities to develop input-output data and develop regular reports on the functioning of GVCs. Progress would also require engaging with interested developing countries in a collaborative reflection on the role of GVCs in their economies (e.g. through the Trade Policy Review Mechanism).

The initiative to create a “Global Value Chain Development Platform” is slightly more ambitious and would need to be driven by a consortium of policy research institutions or intergovernmental organizations or a combination of both (e.g. OECD, UNCTAD, ITC, WTO, World Bank, universities, think tanks). This would ensure high quality standards, independence and continuity in the process. The organizations in the consortium could fund the creation and operation of the platform and could take on the responsibility of keeping it up to date and facilitating the dissemination of relevant information. The buy-in of regional development banks would be critical to the platform’s successful operation.

The “supply chain councils” could be led by international trade analysts but should be primarily comprised of private firms whose input and business insights would be essential in understanding how the networking process actually operates in a particular sector. The councils should have the ability to closely engage with the private sector as well as regulators and trade officials in the mapping exercise. In practical terms, the councils could be hosted within an interested organization with strong participation of the international business community, such as the World Economic Forum or the International Chamber of Commerce.

Finally, a consortium of intergovernmental organizations (e.g. UNCTAD, World Bank, WTO, ITC and regional banks) could carry forward the “Supply Chain Summit.” The summit should obtain the buy-in and support, including financial, from the private sector, as well as the participation of government representatives. From a substantive perspective, the summit could build on the content generated by the “GVC Development Platform.”

The second set of policy options (5 to 7) will imply changes in the way existing international negotiating fora work or undertake negotiations, either by expanding the scope of the talks or by rethinking the manner in which negotiations are structured. These could be aimed at within a medium to longer-term time frame. The first step will consist in systematic and system-wide discussion in the WTO on the implications of GVCs for international trade governance through the creation of a work programme (or work stream) on GVCs and development (option 5). Such a mechanism would provide a space for exploratory discussions and deliberations following the model of existing schemes (e.g. the work programme on small economies which already touches upon GVC-related elements). As with any initiative in the WTO, the process would have to be initiated from inside and led by a group of interested WTO members. At some point, the initiative would have to be discussed at ministerial level.

Policy options 6 and 7 are more ambitious and would require broad consensus among WTO members, which may be difficult to achieve in the short-term. Given the fact that different members will have diverse views, moving forward on a plurilateral basis may be a viable route (Nakatomi 2013). Such an approach would have to be transparent, inclusive, open to new members, and (ideally) designed in a way that would ultimately facilitate the incorporation of these plurilateral agreements within the purview of the multilateral trading system. Alternatively, some countries may choose to use PTAs as a testing ground for new disciplines as a first step (e.g. TPP, TTIP, RCEP, Pacific Alliance, Caribbean Free Trade Area). Avenues could then be explored to either incorporate or link such agreements to the WTO and, where possible and desirable, multilateralize effective practices that may emerge from these PTAs.

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The papers commissioned for the E15 Expert Group on Global Value Chains can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
Informing the design of domestic policies for GVC integration and upgrading					
<b>1. Develop and refine knowledge tools.</b>	Short Term	TiVA database. <i>Ad hoc</i> analysis by IGOs and think tanks/universities.	Limited coverage of TiVA. Limited empirical analysis of GVC functioning and their relation to trade and investment. Limited country specific statistics.	Expand TiVA. Work with national authorities to develop input-output data. Develop regular reporting by WTO Secretariat. Use TPRM to explore role of GVCs in interested countries.	IGOs (e.g. WTO Secretariat, OECD, UNCTAD, ITC, World Bank (WB), and regional banks) and think tanks
<b>2. Establish an independent GVC development platform.</b>	Short Term	Dispersed and uncoordinated analysis on the developmental implications of GVCs. No comprehensive clearinghouse mechanism on the trade and development dimension of GVCs.	No single platform gathering all existing information. Limited space for dialogue and experience sharing. Limited and disperse training and capacity building opportunities.	Creation of a consortium of institutions to develop and maintain an online platform for gathering developing and disseminating analysis. Establishment of a forum for dialogue and exchange of experience.	IGOs (e.g. OECD, UNCTAD, ITC, WTO, WB) and/or think tanks and universities
<b>3. Establish “supply chain councils” to map sector specific supply chains.</b>	Medium Term	Ad hoc and often superficial analysis of the functioning of specific value chains. Lack of understanding by policy-makers of the constraints faced by private sector.	Need to map specific supply chains identifying inputs used, locations, and structure. Need to identify binding regulatory policy constraints affecting the functioning of GVCs.	Councils to be hosted in interested organizations enjoying participation from the private sector. Engage with private sector, regulators, and trade officials in the mapping exercise.	Led by independent analysts but primarily comprised of private firms (e.g. World Economic Forum)
<b>4. Convene a regular Supply Chain Summit.</b>	Medium Term	Same as above.	Limited space for dialogue and experience sharing on GVC functioning and how to promote entry and upgrading of developing countries in supply chains.	Obtain buy-in, support, and participation of private sector and governments. Build on the content generated by the GVC development platform and the supply chain councils.	Consortium of institutions (e.g. UNCTAD, WB, and regional banks) with participation of governments and private sector actors

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Towards a supply chain informed agenda for future trade negotiations</b>					
<b>5. Establish a horizontal work programme on GVCs in the WTO to explore areas where international disciplines might be adjusted or further developed.</b>	Medium Term	<i>Ad hoc</i> and highly fragmented debate on GVCs in the WTO.	No systematic and system-wide discussion in the WTO on the implications of GVCs for international trade governance.	Process to be initiated and led by a group of interested WTO members. Build on and broaden GVC discussion already included under the WTO Work Programme on Small, Vulnerable Economies.	WTO members.
<b>6. Explore the need for new international cooperative frameworks to address possible spillovers.</b>	Long Term	Current WTO disciplines are not designed to respond to the new organization of production and trade. Unilateral action fostering GVC integration and lead firm practices can induce negative externalities.	Key policy areas outside the WTO ambit that impact GVC functioning include investment, competition policy, digital trade, and data transfers.	Use RTAs and plurilateral initiatives as testing ground for new disciplines as a first step (e.g. TPP, TTIP, RCEP). Explore opportunities for multilateralizing best practices.	Governments in multilateral, plurilateral, or bilateral negotiations.
<b>5. Adopt a supply chain informed approach in future trade negotiations.</b>	Long Term	Current trade negotiations happen in silos, dealing separately with goods, services, or investment.	Need for a more horizontal and integrative approach matching the way in which investment, output, and trade processes are organized. A cluster approach could be a promising route.	Same as above.	Governments in multilateral, plurilateral, or bilateral negotiations.

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The experts all participated in their personal capacity. The views and recommendations expressed in the policy options paper are not attributable to any institution with which members of the E15 Expert Group are associated.



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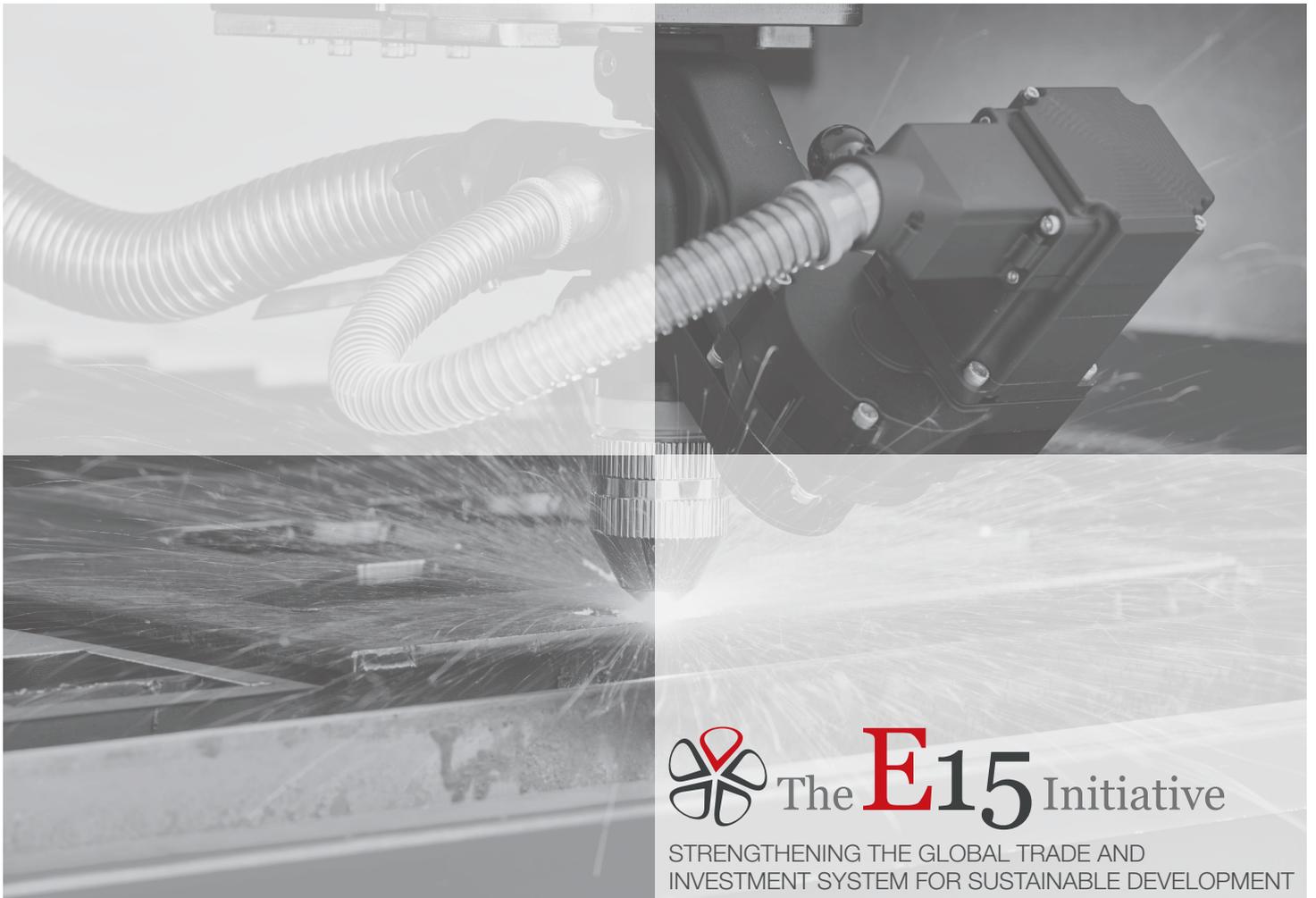
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# New Industrial Policy and Manufacturing: Options for International Trade Policy

Policy Options Paper



 The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND  
INVESTMENT SYSTEM FOR SUSTAINABLE DEVELOPMENT

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# New Industrial Policy and Manufacturing: Options for International Trade Policy

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on behalf of the E15 Expert Group on Reinvigorating Manufacturing: New Industrial Policy and the Trade System

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on New Industrial Policy and the Trade System. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces and two overview papers commissioned by the E15Initiative and authored by group members. Harsha Vardhana Singh was this author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do full justice to the diverse views in all cases. The policy recommendations should therefore not be considered to represent complete consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15Initiative:  
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# Abstract

Industrial policy is not new yet it has seen a revival in recent years in economies across the income ladder. This revived industrial policy is less about market restrictions, focusing more on the facilitation of R&D, technological innovation, productivity gaps, and competitiveness, as well as system-building and coordination-enhancing policies that promote interlinked activities with a horizontal impact. Its objectives can also include addressing larger goals reflecting global concerns. Despite this renewed emphasis, little attention has been paid to the link between new industrial policy and the world trade and investment systems in the 21st century. The present paper seeks to examine the challenges raised and the opportunities availed by the resurgence of industrial policies and their overlap with the global trading system. Based on this examination, a set of policy options are put forward for improving international trade rules to support industrial policy goals that enhance competitiveness and sustainable development. Given the large scope of industrial policy and the major gaps in information as well as technical and institutional capacities that prevail in many developing countries, the paper considers policy initiatives

that cover the following areas: (i) providing better and relevant information to individual countries; (ii) improving the capacities of policy-makers and businesses; (iii) identifying legal constraints due to international agreements and addressing those that are most binding; (iv) examining issues for which stronger international legal disciplines may be necessary; (v) identifying non-legal issues to be addressed cooperatively by nations and the private sector to enhance the effectiveness of industrial policy; (vi) preparing the ground for indices to guide policy and help with prioritization among various policy steps; (vii) suggesting ways of moving from plurilateral to multilateral frameworks; and (viii) initiating regional or international cooperative schemes. One of the pillars of the recommendations is the establishment of Regional Centres of Excellence where policy-makers and business representatives could convene to discuss and address practical policy concerns, and where mechanisms to bridge information gaps and capacity constraints could be developed.

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Abbreviations	
AFIRST	Agreement to Facilitate Inclusive Roadmap for Sustainable Development
ASCM	Agreement on Subsidies and Countervailing Measures
EP	export promotion
FDI	foreign direct investment
FTA	free trade agreement
GATT	General Agreement on Tariffs and Trade
GPA	Government Procurement Agreement
GVC	global value chain
HIC	high-income country
ILO	International Labour Organization
IM	import substitution
IP	industrial policy
ISO	International Organization for Standardization
ITC	International Trade Centre
LCR	local content requirement
LDC	least developed country
LIC	low-income country
LMIC	lower-middle-income country
MFN	most favoured nation
MIC	middle-income country
OECD	Organisation for Economic Co-operation and Development
PPP	public-private partnership
R&D	research and development
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TTIP	Transatlantic Trade and Investment Partnership
UMIC	upper-middle-income country
UNCTAD	United Nations Conference on Trade and Development
UNFSS	United Nations Forum on Sustainability Standards
VER	voluntary export restraint
WTO	World Trade Organization

# Executive Summary

A considerable body of literature has emerged that makes a case for new types of trade policies and links to industrial policies. There is recognition that countries have historically relied on industrial policy to promote economic growth and development, thus replacing the primacy of non-interventionism seen a couple of decades ago. Taking account of a globalized market with growing interlinkages between trade, investment, services, technology, and global value chains, today's industrial policy initiatives reflect a more comprehensive perspective on the steps required to build domestic capacities and systems. However, despite this renewed emphasis, little attention has been paid to the link between new industrial policy and the global trade and investment system in the 21<sup>st</sup> century. Although the global trade system already has many rules relating to the use of industrial policies, a review of existing agreements in relation to "new" policies across the entire spectrum of economic activities in manufacturing, agriculture, and services, has not been considered in depth.

Given this context, the Expert Group on New Industrial Policy and the Trade System was convened as part of the E15 Initiative, jointly implemented by ICTSD and the World Economic Forum. The National School of Development at Peking University supported the Group as knowledge partner. The objective of the Expert Group was to examine the challenges raised and the opportunities availed by the resurgence of industrial policies and their overlap with the global trading system. The Group examined the empirical evidence on types of industrial policies used by countries at different levels of development, and identified the constraints on the use of such policies imposed by existing WTO rules as well as through evolving disciplines under mega-regional and other free trade agreements. It also considered whether there are any important public objectives of common multilateral concern implemented through industrial policy, which could suggest a need to expand the flexibility available in present trade regulatory regimes. Based on these assessments, the Group proposed options for improving international trade rules to support industrial policy goals that enhance competitiveness and sustainable development.

## Systemic Changes

There are ongoing systems-oriented changes that carefully need to be factored into analysis of the interface between trade and industrial policies. These include: (i) economic shifts within nations, which imply a need to adapt relevant industrial policies to evolving domestic conditions; (ii) the rapid growth of developing countries, which has altered the conditions of competition between national economies;

(iii) increasing competition in world markets, which means that acquiring technological capacities for countries at all levels of income has become a *sine qua non* for industrial policy; (iv) the emergence of disruptive technologies with large economic impact, which has altered the operating environment of international economic interaction; (v) the importance of sustainable development considerations in the market and the growth of private standards, which are increasingly mandated by industry, civil society, and policy-makers in response to social expectations; (vi) the growth of global value chains, which has shifted the focus of industrial policy towards enhanced supply chain participation and upgrading; and (vii) the growing overlap that has developed among various policy issues—including services and goods regimes as well as investment and the expanded scope of trade policy behind border measures—which call for greater policy coordination within government and between policy-makers and the private sector.

In view of these systemic changes, policy-makers have to consider a broad number of variables relevant to industrial policy in today's world economy. Moreover, the objectives of industrial policy will be manifold. It is thus crucial that some prioritization among them be made to give greatest effect to policy efforts. Two initiatives would merit special focus. One is to develop systems-oriented changes that facilitate the operations of enterprises and industries and pave the way for improved competitiveness, recognizing the critical role of trade policy. Another is to develop good working relationships between the government and producers at the sector or enterprise level. Finally, industrial policy experiences include both successes and failures. A flexible system that monitors and adapts as required is appropriate. If the market is seen as not responding to the flexibilities, support, or incentives provided by industrial policy, then there will be a need to review the reasons for this lack of response and adapt policy accordingly.

## Options for International Policy

Discussion at the international level is often in terms of policy interventions. Nonetheless, industrial policies are mostly domestic policies and thus any analysis of the international dimension has to begin by examining certain relevant features of these domestic policies. For instance, if effort has to be made at the international level to ease operational conditions for any policy, it would be pertinent to understand the significance of specific policies at the domestic level and whether or not international effort is needed to facilitate the use of that policy. The strategy under current conditions would have to recognize that industrial policy is not a collection of policies but a set of processes. It

is a systematic and structured effort about taking advantage of investment opportunities for a society, with the specific methods being chosen in light of the constraints facing a state at any given time. These constraints dictate the eclectic mix of policies that have been observed as an intrinsic part of promoting economic development in the diverse circumstances that countries have faced and will continue to address in the future.

Given the large scope of industrial policy and the major gaps in information as well as technical and institutional capacity constraints that prevail in many countries, the paper considers policy initiatives that reflect new policy insights and evolving global market conditions.

First, industrial policy has been increasingly reoriented, prompting a shift in emphasis from hard towards soft policy options. Further, there has been a concurrent move towards investment-oriented policies. Empirical or practical experience have validated the expectation that system-building and coordination-enhancing policies, or so-called soft policies promoting a number of interlinked activities with a horizontal impact, are likely to have a relatively larger reach. In this context, an important point is that less developed countries find it especially difficult to implement soft or horizontal policies due to capacity constraints.

Second, since developing countries have several information gaps and capacity constraints, it is useful to set up an international cooperative approach to gather information based on case studies and the experience of nations in addressing specific issues. This is essential for relevant insights and improving the effectiveness of policy options. Moreover, the tendency towards an increased reliance on public-private partnerships to supplement the efforts of various industrial policies, and the overlap between policies required to meet important objectives, are other areas of cooperation in information sharing. It is noteworthy that countries do not sustain the same bundle of industrial policies as they develop. It is thus important to track the type of policies implemented by countries in different income categories, ranging from low- to high-income economies, as well as the transition to new policy frameworks.

Third, a broad range of tools are used to achieve the objectives of industrial policy, of which the most important include subsidization, local content requirements, and the facilitation of both R&D and operating conditions for business. The arguments highlighting constraints imposed by legal systems in relation to these instruments are not that policy avenues for development are fully closed, but that some policies that were more freely available in the past are now curbed by the rules of legal agreements such as the WTO. Based on an assessment of the overlap between the measures most frequently used for industrial policy purposes and the most binding constraints in legal agreements, it may be worth examining the case for altering the disciplines that cover local content requirements, including through a combination of greater disciplines and flexibility, together with a consideration of benefit sharing between investor and host country. Yet another criterion for considering possible flexibilities arises if an important global

or social objective is to be met through industrial policy but the requirements under legal agreements such as the WTO constrain the implementation of that policy. Revisiting the issue of environmental subsidies may be pertinent in this context.

Fourth, in tandem with the view that greater flexibilities within international agreements need to be considered, there is also an understanding that greater disciplines, in certain cases, are required. These include more disciplines for anti-dumping and countervailing measures as well as capacity-enhancing fisheries subsidies. Applying the same criteria used to assess the need for greater flexibilities in legal agreements—namely a large incidence or impact of policy as well as the need to address key externalities of global importance—both of these policy areas qualify as deserving emphasis for additional disciplines, which for example are currently arising or being considered in bilateral and plurilateral arrangements.

Fifth, plurilateral agreements with a large coverage, such as the Trans-Pacific Partnership for example, will result in an increase in operational constraints on industrial policy relative to those that currently exist under the WTO. This has three implications: (i) the available policy flexibilities will be affected for tariffs, intellectual property rights, processes that affect standards (including standards emphasizing sustainable development), state-owned enterprises, and electronic data transfers; (ii) the new plurilateral agreements will result in higher standards in the markets covered by members, with lead firms in these markets replicating such standards throughout their global value chains; and (iii) given the major importance of an inclusive multilateral system for sustaining development and mitigating disputes, it is important to seek avenues to move from the limited coverage agreements towards the multilateral trading system.

## Policy Recommendations

The paper concludes by offering 18 policy options for consideration over the short to medium term. The aim of the options is to provide better information to individual countries and improve the capacities of policy-makers and businesses in relation to the design and application of industrial policies. They also seek to address the most binding legal constraints of relevance in international agreements while attending to areas where stronger disciplines may be called for. The options further deal with non-legal issues to be addressed cooperatively to enhance the effectiveness of industrial policy, including efforts linked to global value chains, as well as the rationalization of indices to guide policy and prioritization. In addition, ways of moving from plurilateral agreements towards multilateral frameworks in select areas are suggested. One of the pillars of these proposals is the establishment of Regional Centres of Excellence where policy-makers and business representatives could convene to discuss and address practical policy concerns, and where mechanisms to bridge information gaps and capacity constraints could be developed.

# 1. The Revival of Industrial Policy

Industrial policy is not new. However, there is now a considerable body of literature that makes a case for new types of trade policies and links to industrial policies.<sup>1</sup> There is recognition that countries have historically relied on industrial policy to promote economic growth and development, thus replacing the primacy of non-interventionist government policies seen a couple of decades ago (Stiglitz 2002).<sup>2</sup>

The revival of industrial policy is driven, *inter alia*, by five main forces. First, there is the pressure to reduce unemployment and stimulate growth after the recent financial and economic crisis. Second, popular domestic demands for more proactive government action to address the difficult socio-economic situations reflecting the multiple “crises” in finance, economy, food, health, and the environment. Third, a desire to develop the manufacturing sector both in developing countries (for example, India and South Africa) and in developed nations. Fourth, low-income countries (LICs) and middle-income countries (MICs) want to participate more actively in global production chains and develop their comparative advantages in labour-intensive as well as strategic technology/capital-intensive sectors. Fifth, after the success of fast-growing economies such as China, India, and South Korea, there is pressure on developed countries to respond to commercial rivalry from emerging economies, and low- and middle-income economies are eager to learn from the experiences of those countries (Economist 2012).

The renewed emphasis on industrial policy in many instances specifically takes the form of reinvigorating manufacturing for sustained growth. An important priority is to foster competitiveness through promoting specific skills, relevant technologies and markets, and developing public-private partnerships to generate investment and derive synergies for upgrading investment, innovation, and diversified domestic production structures.

Taking account of a globalized market with growing interlinkages between trade, investment, services, technology, and global value chains, today’s industrial policy initiatives reflect a more comprehensive perspective on the steps required to build domestic capacities and systems. The emphasis is not only on strengthening the domestic market or manufacturing, but also on how to develop better links with international markets to enhance emerging commercial opportunities through trade and investment, and value chains incorporating both goods and services. Product quality, quick response to commercial requirements, and linking up with international technological developments also become important policy objectives.

Thus, new investments primarily focus on building domestic technological capacities and often involve public-private partnerships and innovative sustainable industrial policies. Experience has also shown that a successful industrial policy strategy would seek to achieve a requisite balance between various objectives such as diversification, competitiveness, and increasing productivity.

Despite these many new features and initiatives, little attention has been paid to the link between new industrial policy and the global trade and investment system in the 21st century. Although the global trade system already has many rules relating to the use of industrial policies, a review of existing agreements in relation to “new” industrial policies across the entire spectrum of economic activities in manufacturing, agriculture, and services, has not been considered in depth.

Given this context, the Expert Group on New Industrial Policy and the Trade System was convened as part of the E15 Initiative, jointly led by ICTSD and the World Economic Forum, which aims, through non-partisan and expert-led multi-stakeholder dialogue, to explore options for strengthening the governance and functioning of the global trade and investment system for sustainable development. The National School of Development at Peking University supported the Expert Group as knowledge partner.

The objective of this E15 Expert Group was to examine the challenges raised and the opportunities availed by the resurgence of industrial policies and their overlap with the global trading system. The Group identified the constraints on the use of such policies imposed by existing WTO rules, as well as through evolving disciplines under the mega-regional and other free trade agreements (FTAs). Based on these assessments, the Group proposed options for improving international trade rules to support industrial policy objectives that enhance competitiveness and sustainable development.

To accomplish this objective, the Group’s work was implemented in two steps. The context and relevant issues were discussed in depth during three workshops. Select experts in the Group prepared think pieces on certain issues identified in these workshops. These think pieces examined the empirical evidence on types of industrial policies used by countries at different levels of development and resource availability. The Group further assessed the extent to which the global trade system either imposes a binding constraint or provides adequate flexibility on the use of these policies. In particular, it discussed how trade disciplines in mega-regional FTAs are evolving so as to restrict or increase acceptance of certain industrial policies. It also considered whether there are any important objectives of common multilateral interest (e.g. environmental objectives) implemented through industrial policy, which imply a need to expand the flexibility available in the present trade regulatory regimes, and, if so, how this could be achieved.

<sup>1</sup> See, for example, Ciuriak et al. (2011).

<sup>2</sup> See also Stiglitz and Yifu (2013).

# 2. Systemic Changes and Implications

## 2.1. The Coverage and Evolution of Industrial Policy

### 2.1.1. Which activities are promoted by industrial policy

Industrial Policy has been given different meanings depending on the objective and perspective of the person focusing on it. The definitions range from the encouragement of a “specific industry” to the implementation of an “entire development strategy.”

An industrial policy is a government-sponsored economic growth programme that encourages development of, or investment in, *a particular industry*. Industrial policies may target local, regional or national development of an industry by any number of means (Kim and Dobbin 2014, emphasis added).

The policies of a nation that help guide the *total strategic effort* of the country. The policies influence the development of different sectors and create a stronger portfolio of national industry (BusinessDictionary.com, emphasis added).

In practice, as Chang (1994) has shown, industrial policy is used pervasively for development objectives. Dani Rodrik (2008) emphasizes the need for wide-ranging industrial policies on the grounds that “development is fundamentally about structural change: it involves producing new goods with new technologies and transferring resources from traditional activities to these new ones.”<sup>3</sup>

### 2.1.2. Industrial policy has long been used by all

Use of industrial policy is not new.<sup>4</sup> For instance, Gerschenkron (1962) discusses policy interventions implemented in the nineteenth century to promote growth and development in nations such as Germany and Japan, which were then latecomers to Great Britain on the path of industrialization.<sup>5</sup> Alternative views have emerged regarding

Gerschenkron’s analysis, but a key feature which stays unchanged is that policy intervention did take place in these now developed countries.<sup>6</sup> In varying degrees, industrial policy has continued until today across various countries, though with different patterns and emphasis during different stages of the development.<sup>7</sup>

### 2.1.3. Evolution of industrial policy

The dominant thinking on industrial policies has evolved over time. Earlier, industrial policies were linked to import substitution (IM), through, *inter alia*, trade protection. The focus was much more on internal, domestic markets rather than export markets. Subsequently, especially during the 1980s, some countries started focusing on export promotion (EP), developing greater linkages with markets abroad through policies supporting exports. A combination of policies was used, focusing on both imports and exports, with import restrictions used to protect domestic producers, but policy support provided for entering and competing in export markets.<sup>8</sup> This culminated in a pervasive view that policies should not restrict markets and instead should allow markets to play a more unencumbered role.<sup>9</sup> This so-called Washington Consensus broke down as the world faced major problems in areas of food security, environment, finance, and economic activity. Today, we are once again back to a combination of policies, which include market restrictions as well as market opening initiatives across the entire range of countries, though the content and structure of industrial policy has evolved. Compared to the earlier situation, we now have a very different economic environment, and industrial policy has to operate in circumstances that differ substantially from about four decades ago. In a reconsideration of new industrial policy, we may have to think not only in terms of soft/hard, vertical/horizontal policy constructs, but also go beyond these categories to a much wider conceptual framework. The following section examines the key ongoing systems-oriented changes of today.

<sup>3</sup> For other definitions of industrial policies, see Lee et al. (2013); and OECD and EDFI (2013).

<sup>4</sup> See for example, Peres and Primi (2009).

<sup>5</sup> For a more recent discussion of the issues, see Sylla and Wright (2004)

<sup>6</sup> See for example, Dornbusch et al. (1987, 403–06).

<sup>7</sup> For the post-1945 industrial experience of Europe, see Grabas and Nützenadel (2013)

<sup>8</sup> See for example, Dornbusch et al. (1987, 403–06).

<sup>9</sup> It is noteworthy that the actual policy situation continued as a mixture in most countries. As Grabas and Nützenadel (2013, 75) state: “Although many studies mostly hide these historical facts and rather highlighted the achievements of neoliberal policies during this period, it is important to stress, that on a national level in most Western European countries strong interventionist industrial policies still prevailed. ...In fact, even from the mid-1970s onwards up to the early 1990s, national industrial policies remained strongly interventionist and rather reactive in order to protect home industries.”

#### 2.1.4. Realigning concepts with reality

One way on which a conceptual realignment might be achieved is to think of public interventions in terms of investments and to consider the implications of the range of risk/return combinations that characterize potential investments.

Private investment responds to risks and returns. Not all combinations of risk and return will elicit private investment. Those that will not elicit private sector engagement involve (a) non-appropriable returns, (b) heavily time-discounted returns, and/or (c) unquantifiable risks. Accordingly, there is a range of investments open to a society at any time that may have great benefits and must be undertaken or underwritten by the public sector or else they will remain on the table.

Where the investment opportunities will be passed over by the private sector because of uncertainty, but where success in the endeavour would result in an investment the returns to which are appropriable, the correct role of the public sector is that of underwriter.

- A classic industrial policy intervention of this sort is the government acting as “launch customer” for the development of the silicon chip, solar panels, etc.

Where the investment opportunities are passed over by the private sector because the benefits, though great, would not be appropriable, the correct role of the public sector is to undertake the investment directly, as a public sector enterprise.

- The cost of the Ebola outbreak to the core three countries (Guinea, Liberia, and Sierra Leone) in terms of GDP foregone is estimated by the World Bank to be on the order of US\$1.6 billion in 2015 alone, with spillovers on Sub-Saharan Africa ranging from US\$550 million to US\$6.2 billion, depending on how successful containment is. The expected appropriable returns to a vaccine manufacturer prior to the outbreak would be a tiny fraction of these costs, and even after the outbreak public sector funding is required because those at risk cannot afford to pay the high prices that pharmaceutical firms would require to recoup developmental costs.
- To the response that the public sector lacks the capabilities, the answer is that part of the required investment may be to develop and maintain the public sector enterprises/laboratories that are capable of undertaking such development, including benchmarking them with best practices and adopting mechanisms for working with private investment.

There are certain corollaries to this reformulation of the basis for industrial policy.

- a) Since investments with large positive externalities are particularly valuable from a societal perspective, it follows that public-private partnership models such as university-industry technology transfer arrangements that (by design) emphasize appropriable investments need to be complemented by purely public ventures that focus on non-appropriable investments.
- b) If the investments open to a society expand with its technical capabilities, the investments open to public sector engagement are greater the higher the level of development of an economy. The key aspect however is whether or not the private sector would be willing to perform the same task in such a technically advanced economy.
- c) The nature of industrial policy will vary from country to country. For countries with underdeveloped private sectors, industrial policy will be seen to be engaged in developing capabilities in areas that are handled by the private sector in more developed economies.

As indicated, the re-engagement of the policy community with industrial policy is taking place in circumstances that differ substantially from about four decades ago, when the present consensus started to take shape. The above characterization of industrial policy may provide a fresh lens through which to examine the emerging policy landscape without simply rehearsing the old debates that led to the present consensus. It validates what is actually observed—a mixed model of economic development:

- Industrial development continues to be driven by a combination of public sector and private sector engagement as it was historically; and
- There is industrial policy activism by the most highly advanced economies as well as less developed economies—i.e. development of the private sector and of financial markets does not obviate the need for public sector engagement.

## 2.2. Key Ongoing Systems-Oriented Changes

### 2.2.1. Economic shifts within nations imply changes in relevant industrial policies

As an economy develops, its domestic economic conditions change resulting in an adaptation of the pertinent industrial policy initiatives. With a change in the economic structure of developing countries, their policy focus would also have to adapt as a result of different domestic conditions. A good example is in the following assessment by the World Bank and China’s Development Research Centre of the State Council (2013, 16-18, emphasis added).

Developing countries tend to benefit from the latecomer’s advantage by following a development path adopted by others. This path makes the role of government relatively straightforward—providing roads, railways, energy, and other infrastructure to complement private investment, allowing open trade and investment policies that

encourage technological catch-up, and implementing industrial policies when market and coordination failures inhibit the development of internationally competitive industries consistent with the country's comparative advantage.

The development strategies of East Asia's successful economies—Japan; Korea; Hong Kong SAR, China; Singapore; and Taiwan, China—have all broadly reflected these features. *But when a developing country reaches the technology frontier, the correct development strategy ceases to be so straightforward. Direct government intervention may actually retard growth, not help it.* Instead, the policy emphasis needs to shift even more toward private sector development, ensuring that markets are mature enough to allocate resources efficiently and that firms are strong and innovative enough to compete internationally in technologically advanced sectors.

Lastly, while the government reduces its role in markets, resource allocation, production, and distribution, it should step up its role in financing public goods and services, protecting the environment, increasing equality of opportunity, and ensuring an environment conducive for private sector development. Playing such an indirect and supportive role is complicated but will have a wide impact, with greater leverage through the private sector and social organizations. *While providing fewer “tangible” goods and services directly, the government will need to provide more intangible public goods and services, like systems, rules, and policies, that increase production efficiency, promote competition, facilitate specialization, enhance the efficiency of resource allocation, and reduce risks and uncertainties.* It requires designing and implementing incentive structures that lead to desired and sustainable outcomes.

It is noteworthy that it is precisely at the technology frontier where public intervention today in the most advanced economies is heaviest and overtly “vertical” through the support for “sunrise” industries—and precisely to invigorate growth at a time when private capital is not active or looks for public support. Interestingly, recent work on industrial policy suggests that the role of system building and private sector development/participation is relevant not only for relatively advanced developing economies such as China, but for all countries.<sup>10</sup>

Industrial policy currently emphasized in developed countries has also evolved. Consider for example, the case of Europe as explained by Grabas and Nützenadel (2013, 84, emphasis added).

In 1990 the [European] Commission published a communication entitled “Industrial Policy in an Open and Competitive Environment. Guidelines for a Community Approach” which was soon welcomed and supported by the member countries. ... This communication also set up the main objectives for industrial policy of the

Community which are still just as important and valid today: *Greater openness of the world trading system, R & D policy, competition policy, social and employment policies, consumer protection, public health policy and environmental protection.*

The above quotations show how economic shifts have resulted in an evolution of public policy both in terms of its changing emphasis and the emerging concerns relating to competitiveness and social issues. An important aspect to keep in mind is that building a new knowledge base is not an automatic process. Specific and focused effort or attention is required. The policy content and mechanisms required for growth in countries at different levels of income or development are not the same, and would need different prioritization and systems to effectively meet the policy objectives relevant for different economies. Likewise, the process and nature of R&D differ in developed and developing countries, with the former focusing more on creating new technologies and the latter more on the acquisition and absorption of technologies.

### 2.2.2. Countries and firms face greater competition

The pace of growth in developing countries has increased faster than that of developed nations. From 2006 to 2014, for example, the average growth rate of developing countries exceeded that of developed countries by over 4.6 percentage points (UNCTAD 2014, 2). This resulted in significant changes in economic rankings among the top global economies (Table 1), which has led to greater competition in global markets.

**Table 1: Top Ten Economies in Terms of GDP (2015)**

	<b>GDP Ranking in 2015 (real)</b> (Brackets show rank in 1990)	<b>GDP Ranking in 2015 (PPP)</b> (Brackets show rank in 1990)
<b>1</b>	United States (1)	China (6)
<b>2</b>	China (10)	US (1)
<b>3</b>	Japan (2)	India (8)
<b>4</b>	Germany (4)	Japan (2)
<b>5</b>	United Kingdom (6)	Germany (3)
<b>6</b>	France (4)	Russia (n.a.)
<b>7</b>	India (11)	Brazil (7)
<b>8</b>	Brazil (9)	Indonesia (13)
<b>9</b>	Italy (5)	UK (9)
<b>10</b>	Canada (7)	France (5)

Note: n.a. = Not available / PPP = purchasing power parity  
Source: Knoema 2015

<sup>10</sup> See for example the discussion in Singh and Jose (2015a).

The growth of developing countries, including some becoming major economies, has resulted in a shift from a bi-modal to a multi-modal global economy, wherein new competitors challenge erstwhile dominant economies in global markets.<sup>11</sup> Thus, concerns regarding conditions of competition become very significant for developed economies. An indication of such concerns has been emphasized by the EU and the US in their Joint Statement on shared principles for international investment (EU and USA 2012, emphasis added).

To this end, the European Union and the United States support the work of the Organisation for Economic Co-operation and Development (OECD) in the area of “*competitive neutrality*”, which focuses on the importance of state-owned entities and private commercial enterprises being subject to the same external environment and competing on a *level playing field* in a given market.

Competitive neutrality aims to ensure that the conditions of commercial operation faced by producers in developed economies are also faced by producers in all major markets. To some extent, this is the effort underway through negotiations such as the Trans-Pacific Partnership (TPP) Agreement, which aims to create a 21<sup>st</sup> century trade regulation regime.

Interestingly, while developed economies seek to respond to the greater competition from middle-income economies, the latter find themselves facing increasing competition in their conventional markets from low-income economies, as well as competition from high-income economies in more complex and higher value-added products. Likewise, for low-income economies, the emergence of new producers imply rising competition.

### 2.2.3. Technological upgrading as a key aspect of industrial policy

With increasing competition in global markets, acquiring technological capacities and competence for countries at all levels of income has become a *sine qua non* for industrial policy.

Traditionally, low-income economies rely on relatively simple technologies and thereby emerge as competitors in less complex products.<sup>12</sup> In order for such countries to meet aspirations for continued growth, a key requirement is that they continue their process of technological upgrading.

As low-income economies become increasingly competitive in markets where middle-income economies traditionally had a dominant presence, the latter have to respond by becoming even more competitive and innovative, including by shifting to new sectors. Further, since middle-income economies aspire to transition to upper income levels, they must acquire capacity to produce high value products with greater technological content relative to their prevailing production patterns, including greater domestic capacities in sunrise industries. This is not an automatic process, especially in an increasingly interlinked global economy where the level of competition is intensifying. The main issue to consider is whether the government can assist in the process of development and, if so, what policies and mechanisms are more appropriate for doing so. An increasing focus on industrial policy arises due to the examples of countries which have managed to achieve historically exceptional growth performance, and the content has to keep in mind the fact that operation conditions for achieving the objectives of growth and development have changed and continue to evolve with ongoing changes in markets, links between value chains, technological change, large FTAs, and experience with both soft and hard policy initiatives.

Similarly, high-income economies are facing competitive pressure in a number of sectors where they had been undisputed leaders.<sup>13</sup> Therefore, developed economies have to work hard to maintain their technological leadership by continuing to shift the technology frontier.<sup>14</sup>

These three types of situations require different types of policy mix, but each of them has a common thread—i.e. the importance of technological upgrading for transition towards a richer economy. As stated by Stiglitz et al. (2013): “If improvements in standards of living come mainly from the diffusion of knowledge, learning strategies must be at the heart of development strategies.”

### 2.2.4. The emergence of disruptive technologies with large economic impact

There are interesting implications of upper-income economies shifting the technology frontier. These include:

- First, new technologies tend to have a large impact on the way production and consumption takes place, including highly disruptive effects on the way markets function;<sup>15</sup> and
- Second, upper-middle-income economies have acquired good abilities to both use/adopt these technologies and to improve them, including through foreign direct investment (FDI). Therefore, the catch-up time is now lower, and industrial policy is an important tool in this catch-up process.

<sup>11</sup> See for example, Subramanian and Kessler (2013).

<sup>12</sup> Ramdoo (2015) provides an interesting discussion of industrial policy initiatives in low-income economies.

<sup>13</sup> This is shown for example by the Product Life Cycle Theory of international trade, where new products always come up in developed economies and then multinational enterprises take them over time to developing economies as their markets become more mature for these products. In today's world, this neat time sequence is being disrupted with a number of new products coming up in developing economies as well.

<sup>14</sup> Weiss (2015) discusses industrial policy (IP) in upper income economies in terms of defensive IP, catch up IP, and innovation based IP. The initiatives we mention here would in effect come under each of these categories.

<sup>15</sup> See for example, Manyika et al. (2013).

Historical experience shows that innovative efforts to upgrade technologies lead from time to time to disruptive changes that can completely change the operating conditions of international economic interaction. In the recent past, Internet, mobile technology, biotechnology, and new types of materials are examples of such technologies.<sup>16</sup> This trend is continuing, as expected, and even at present there are a number of “disruptive” technologies on the threshold that could greatly transform global economic opportunities.<sup>17</sup> Important features of disruptive change in comparison to earlier periods include the faster speed with which change is taking place and that these changes occur both at the general industry level as well as at the level of individual industries, thereby creating business opportunities.

An important objective of industrial policy is to alter a country’s dynamic comparative advantage. To do so it is critical to absorb or develop new technologies that have widespread economic effects.<sup>18</sup> A critical policy package would require a country to develop linkages with sunrise industries, which best embody the new technological paradigms that affect the way in which production, trade, and investment could evolve in the next decade or so. An important route for countries to acquire this capability is through FDI, which helps upgrade domestic technological abilities.<sup>19</sup> For countries that might have trouble to attract FDI, another alternative is to use outward FDI to acquire the technology (Ciuriak and Bienen 2014).

To acquire new technological capacities, a country may use several methods such as:

- Forming and participating in a public-private R&D (research and development) consortium;
- Encouraging co-development contracts with foreign/R&D specialist agencies or firms;
- Fostering indigenous firms by learning from FDI firms;
- Promoting academic institutions-run enterprises in forward engineering; and
- Acquiring foreign technologies and brands through M&As (mergers and acquisitions).

### 2.2.5. Increasing importance of sustainable development and social standards in the market and the growth of private standards

An important change in global markets, especially for developed economies, has been a rising emphasis on sustainable development and social standards mandated by industry, civil society, and policy-makers reflecting

changes in social expectations. This emphasis is indicated for instance by the OECD Guidelines for Multinational Enterprises (OECD 2011),<sup>20</sup> the aforementioned Joint Statement of the EU and US on investment agreements, the topics covered in mega-regional negotiations such as the TPP, and the recent G7 Declaration’s section on “Responsible Supply Chains” (G7 Leaders 2015, 6). Furthermore, increasing emphasis on social issues has led to a proliferation of private standards in developed economies, for which the impact on the rest of the world becomes significant when the lead firms in supply chains emphasize such standards. These changes will become even more prominent when the recent Declaration by the G7 pertaining to responsible supply chains takes effect. The Declaration states the following (emphasis added).

Given our prominent share in the globalization process, G7 countries have an important role to play in promoting labour rights, decent working conditions and environmental protection in global supply chains. We will strive for better application of internationally recognized labour, social and environmental standards, principles and commitments (in particular UN, OECD, ILO and applicable environmental agreements) in global supply chains. ... We will take action to promote better working conditions by increasing transparency, promoting identification and prevention of risks and strengthening complaint mechanisms. We recognize the joint responsibility of governments and business to foster sustainable supply chains and encourage best practices. To enhance supply chain transparency and accountability, we encourage enterprises active or headquartered in our countries to implement due diligence procedures regarding their supply chains, e.g. voluntary due diligence plans or guides.

The term “internationally recognized” standards is one that can also include a number of private standards that have a major presence in the world market.<sup>21</sup> To the extent that major economies now consider it their joint responsibility to get such standards implemented in the entire supply chain (i.e. even beyond their jurisdiction), and thus are getting involved in striving to achieve this objective, there is a basis to include these standards also within the structure of disciplines in the WTO Agreement on Technical Barriers to Trade. This would also help move towards greater consistency among such standards with large impact on supply chains and global market access conditions.

This tendency will be further enhanced by the mega-regionals, as stated by Ciuriak and Singh (2015).

<sup>16</sup> For other examples, see MIT Technology Review (2014)

<sup>17</sup> See for example, Manyika et al. (2013) and Satell (2013).

<sup>18</sup> See for example, Lee (2015) and Guadagno (2015)

<sup>19</sup> Examples include India’s Make in India programme which is “designed to facilitate investment, foster innovation and enhance skill development,” as well as China’s Tianjin Airport Area.

<sup>20</sup> For labour standards, the International Labour Organization (ILO) guidelines are the source that is usually emphasized.

<sup>21</sup> This can be seen for example from the International Trade Centre (ITC) Standards Map, the United Nations Forum on Sustainability Standards (UNFSS) coverage of private sustainable standards, or the International Organization for Standardization (ISO) publication on International Standards and “Private Standards” (ISO 2010).

Especially as regards standards, private standards in such areas as sustainability and labour will become more relevant in TPP and TTIP countries, thereby raising the bar for firms in developing countries—and, thus, requiring greater industrial policy support from governments to enable firms to participate in global value chains.

Once the mega-regionals come into effect, the impact of these standards on market access will become far more pervasive and onerous. These developments indicate that two different types of efforts will be required. First, improving domestic capacity to meet relevant standards through industrial policy. Second, through collective effort among nations and international institutions, addressing the growth of widely differentiated private standards.

## 2.2.6. Increasing overlap and interlinkages have developed among various policy issues

### 2.2.6.1. Services and goods are no longer separate regimes

There is a growing understanding, both theoretical and statistical, of the importance of services in value chains, trade, and investment as being far more significant than conventionally recognized. The OECD-WTO statistical database on Trade in Value Added shows that the real contribution of services to exports is closer to 40% and not about a quarter as currently estimated. In fact, Lanz and Maurer (2015) suggest that the contribution of services may be greater than that estimated by OECD-WTO.

The increase in value of services is due to the “servicification” of manufacturing, which takes account of the services value-added embodied in goods and the process of production; in developing countries it might be about one third and in developed countries about one quarter (Lanz & Maurer 2015). The extent of services has increased over time also due to improved opportunities to conduct trade in services (or subcontract them) enabled through technological changes, the upgrading of technological capabilities, and improvements in transport and quality maintenance systems.

Services are both embodied in goods and also enable the goods to be produced, stored, transported, and sold. Therefore, commercial activities cannot be considered today separately as either goods or services. They are intricately connected, contribute to each other, and together enable the provision of the product to the final consumer. For a policy-maker, therefore, both goods and services have to be considered together, as common and linked components of value chains.

### 2.2.6.2. Other overlaps

Technological change in production methods, communications, packaging, and transport, together with skill acquisition and FDI, have led to increasing interlinkages among nations. They have also led to the growth of global value chains—i.e. a product being produced through a combination of various components provided by producers located in different nations.

In order for industrial policy to be successful it is important to consider the interaction and overlaps between the various segments of economic activities from trade, investment, value chains (domestic and global), services, technological capabilities, and standards. Such an understanding is critical to facilitate the process of domestic producers transitioning towards higher value-added products and sunrise sectors.

### 2.2.6.3. Expanded scope of trade policy and of its overlap with industrial policy

The close interaction of trade, investment, and domestic and global value chains have expanded the scope of trade policy beyond border measures. Trade policies now increasingly operate “behind the border” through measures such as standards.<sup>22</sup> The larger scope of trade policies is also reflected in the subjects covered under the TPP Agreement (Figure 1).

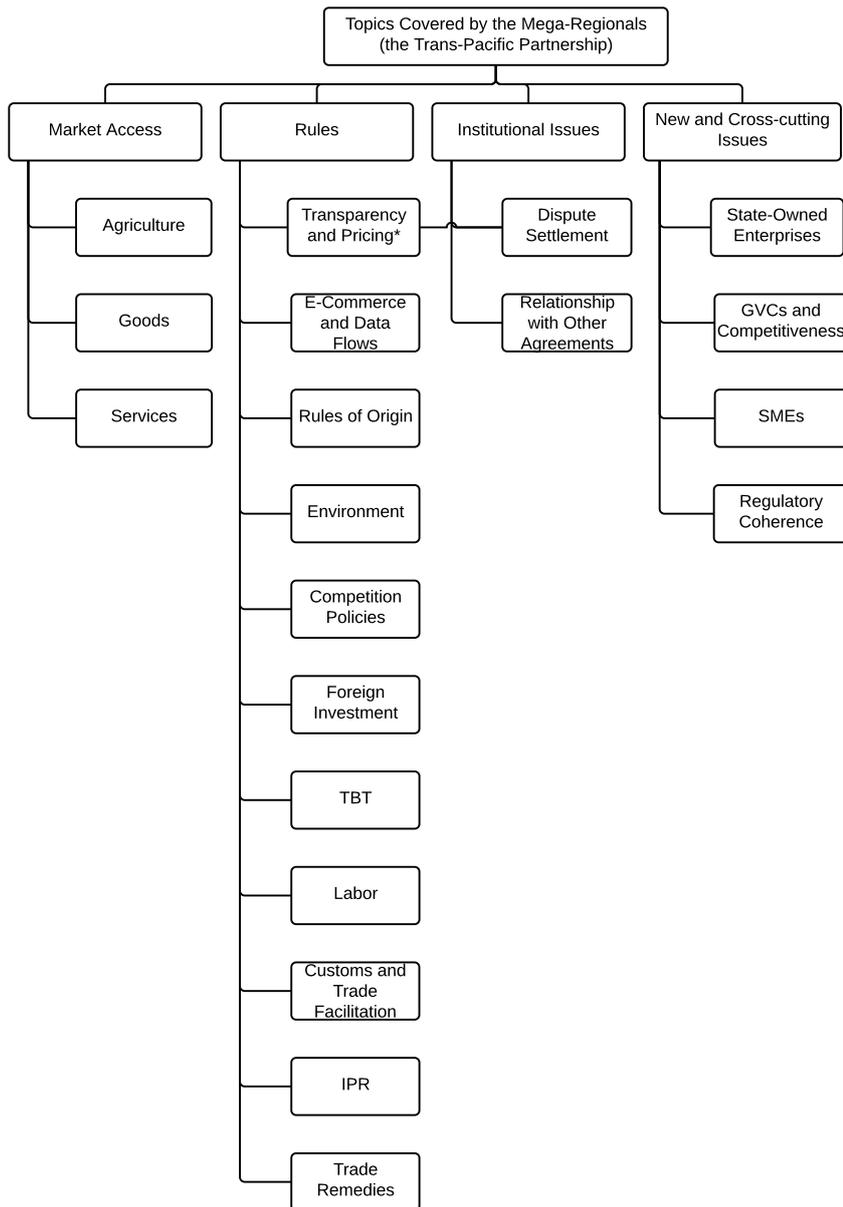
The new trade agreements will have WTO+ disciplines, which will impose additional constraints on policy use. It is noteworthy that the WTO negotiations are stalled and the possibility of progressing seems slim at present. Nonetheless, the WTO system remains important for reducing international discord and disputes linked to trade policy. Sustaining growth and development in an interlinked world requires trade and investment regulatory systems that are inclusive and rely on the principles encompassed in the WTO. In view of the WTO+ regulatory provisions in mega-regionals, countries would need to make special efforts to develop systems to move towards an inclusive multilateral system.

### 2.2.7. Growth of global value chains and implications for industrial policy

Global trade has seen a significant rise in value chains in international trade (Stephenson 2015). An important focus of industrial policy today is to enhance potential links among domestic and global supply chains, acquire a larger share in global value chains, and over time move up the value-added segments of value chains. This requires enhancing domestic capacities of both public and private operatives in order to: quickly obtain and share information; facilitate inventory

<sup>22</sup> With greater competition in global markets to link up with international supply chains, domestic producers have to be more competitive in comparison to other nations’ producers.

**Figure 1: Topics Covered by the Mega-Regionals (e.g. the TPP)**



\* Transparency and Pricing refers to healthcare and pharmaceuticals  
 Source: Fergusson et al. 2015

management; meet commitments in a timely manner; and, establish the linkages with producers downstream and upstream (in both services and goods) (Subramanian and Kessler 2013). It is also important to establish systems for communications and logistics, improve institutions, and facilitate domestic producers meeting the relevant quality

and standards required by lead firms in value chains.<sup>23</sup> Furthermore, given the need to address multiple objectives, policy-makers will also need to consider multiple policy options to efficiently address different objectives. The complexity of the exercise requires prioritization of objectives and related policy initiatives.

<sup>23</sup> For supply chains and policy implications, see Draper (2013). For trade in tasks, see Lanz et al. (2011). On facilitating the process, see Draper (2013) and Cattaneo et al. (2013).

### 2.2.8. Greater policy coordination needed within government and between government and the private sector

The aforementioned overlaps imply that policy-makers need to coordinate and discuss details among various relevant government departments, as well as with the private sector, to implement system-oriented initiatives required for overlapping policy issues.

Such coordination is also required to address some key systemic shortcomings of industrial policy. The main criticisms against industrial policy are that government failures can be much worse than market failures, and that governments can be captured by vested interests (Pack and Saggi 2006). The challenge for governments is to formulate industrial policy and implementation procedures and institutions that embody good governance. In this context, the following suggestions are relevant to improve implementation, which also requires considerable coordination.

The rent-seeking problem can be overcome with appropriate institutional design. ... Intelligent industrial policy requires mechanisms that recognize errors and revise strategies accordingly. Clear objectives, measurable targets, close monitoring, proper evaluation, well-designed rules, and professionalism provide useful institutional safeguards (Rodrik 2014).

Industrial policy has to be coupled with a good deal of discipline and accountability, applied to both private actors and the State. ... Desirable features of good incentive programmes include standard setting, automatic sunset clauses, built-in programme reviews, monitoring and establishment of clear benchmarks for success or failure, and periodic evaluation exercises. These and other instruments can be used to limit the likelihood of abuse and implementing proactive policies based on strong public-private cooperation. Their application, of course, requires competent public agencies and effective coordination (Salazar-Xirinachs et al. 2014, 31).

There are several past examples when a lack of private investment in a desirable economic activity, including socially valuable investment opportunities, was addressed through direct state engagement by establishing a state-owned enterprise. Canada's economic development, for example, featured the creation of many Crown Corporations, which developed backbone sectors such as railways, airlines, and telecommunications, as well as high-risk, high-technology sectors such as nuclear power (enabling Canada to be the world's leading supplier of radioisotopes for medical testing).

### 2.2.9. Concern that internationally agreed disciplines curb policy flexibility required for industrial policy

While the number of objectives to be met through industrial policy are increasing, a specific concern is that legal agreements—for example the GATT/WTO—are changing the policy flexibility available for member countries to

achieve these objectives. One implication of such disciplines is that a number of policies that were historically feasible for industrial policy may no longer be available. This feature has been termed, *inter alia*, as “kicking away the ladder” for the latecomer countries. Although current WTO agreements do provide for broad pockets of policy flexibility, in many fields WTO rules and jurisprudence have become so complicated that it can be difficult for less resourceful countries to pinpoint the legally available instrument to achieve a certain industrial policy. This complexity may lead countries to select (in good faith) the wrong instrument or to give up on the policy altogether. Tailored legal capacity and advice would, in many situations, enable countries to pursue their industrial policies by making optimal use of existing policy flexibilities.

### 2.3. Implications of these Systemic Changes

In view of the many systemic changes briefly described above, policy-makers have to bear in mind a broad number of factors relevant to industrial policy in today's world economy. These include the following.

- Changes required in the types of industrial policies that become important as economies grow.
- Growing overlaps between different economic activities and policies, especially trade, investment, and goods and services.
- The growth of supply chains implies a change in policy focus from restriction to facilitation of trade and investment.
- The crucial role of lead firms in policies linked to global value chains must be recognized.
- Global markets today are characterized by much greater competition, which is likely to keep increasing.
- The key significance of technological upgrading through skill building, developing innovative capacity, and linking up with new products and technologies.
- The crucial role of new technologies implies that the type of infrastructure emphasized now includes that required for new and emerging technologies and skills, rather than mainly physical infrastructure like road, ports, and storage facilities.
- The multiple objectives of industrial policy usually require significant investments implying larger financing requirements than earlier, which means that financial instruments and multiple sources of financing can play a significant role.
- The need to “focus on interventions that help build systems, create networks, develop new institutions, and align evolving strategic priorities” (Warwick 2013).
- Systems and procedures to improve coordination within government and amongst government and private sector need to improve.
- Level playing field concerns in various countries will be addressed not only by firm and industry level policy initiatives, but also through new types of disciplines in bilateral/plurilateral trade and investment agreements.
- Against this background, it is essential to address the possibility of fragmented trade regulation systems and move towards an inclusive and multilateral framework of trade disciplines through coordinated and combined efforts.

- Within present international agreements there is a need to consider whether:
  - In certain cases the lack of policy flexibility imposed by international agreements is unduly strict;
  - Trade agreements should provide greater flexibility to meet some larger social or international objectives, such as for green subsidies;
  - Given the importance of improving competitiveness, there may be a need to increasingly focus on issues related to competition policy.
  - International initiatives would be required also to address the growth of private standards incorporating sustainable development and social standards.

Given this long list of industrial policy objectives, it is crucial that some prioritization among them be made to give greatest effect to policy efforts. Two initiatives would merit special focus. One is to develop systems-oriented changes that facilitate the operations of enterprises and industries and pave the way for improved competitiveness. Another is to develop good working relationships between the government and producers at the sector or enterprise level. In developing countries, improving many of the domestic conditions to be competitive requires a very long timeline. For a development strategy to be credible, it is important to first prioritize the quick wins, so as to prove the effectiveness of an industrial policy strategy. Thus, in general, the prioritization process may be assisted by considering the various initiatives within the framework specified in Table 2 below. Initiatives falling in box 1 should normally have the highest priority. The next highest priority could be initiatives in box 2 together with policies in box 3, which bring about systemic changes. Policy steps in box 4 could be considered to have the lowest priority.

**Table 2: Policy Impact Matrix**

	Large impact of policy	Small impact of policy
Policy impact is immediate	1	2
Policy impact after long time	3	4

It would be important to specifically consider policies that emphasize building global competitiveness, and recognize the critical role of trade policy, improved logistics, trade facilitation, the ability to meet global standards, and the ease of doing business.

In this context, policy-makers may consider identifying areas that are of high risk but with significant positive externalities. The public sector may need to be equipped to directly invest in these sectors, or work with the private sector to provide the investments which the private sector otherwise deems too risky. An example of this is the building of a telecom fibre network or an electricity power grid across a country, such as by public sector companies in India.

An important point to bear in mind is that industrial policy experiences include both successes and failures. Therefore, a flexible system that monitors and adapts as required would be needed. A common method is to implement industrial policies in a time-limited manner, with sunset clauses. Moreover, if the market were seen as not responding to the flexibilities, support, or incentives provided by the industrial policy, then there would be a need to review the reasons for this lack of response. The consequence may be to change or phase-out the policy, or address certain constraints in other linked areas that limit the effectiveness of the policy.

# 3. Options for International Trade Policy

The E15 Initiative examines issues in terms of the implications for international trade and investment systems. Therefore the focus is at the “international” level in terms of policy interventions, their effects, and the agreements and cooperative arrangements among nations. Nonetheless, industrial policies are mostly domestic policies and thus any analysis of the international dimension has to begin by examining certain relevant features of these domestic policies. For instance, if effort has to be made at the international level to ease operational conditions for any policy, it would be pertinent to understand the significance of specific policies at the domestic level and whether or not international effort is needed to facilitate the use of that policy.

The resurgence of industrial policy in recent times has taken place with the memory of past efforts still intact. Thus, validation of industrial policy may be considered as also validating IM strategies adopted in the past, including an emphasis on policies used to restrict market access. For a meaningful and effective evaluation of the issue, it is important to consider the changes in operating conditions to better evaluate what would be the appropriate kinds of policies to use. The strategy for industrial policy under current conditions would have to recognize that industrial policy is not a collection of policies but a “process.” It is a systematic and structured effort about taking advantage of investment opportunities to a society, with the specific mode being chosen in light of the constraints facing a state at any given time, hence dictating the eclectic mix of policies that have actually been observed as an intrinsic part of economic development in the diverse circumstances that countries have faced.

Given the large scope of industrial policy and the major gaps in information and technical/institutional capacities in many countries, we need to consider initiatives that:

- Provide better and pertinent information to individual countries;
- Improve the capacities of policy-makers and business;
- Identify legal constraints due to international agreements and address those that are most binding;
- Examine issues for which stronger international legal disciplines may be necessary;

- Identify some non-legal issues to be addressed cooperatively by nations to enhance the effectiveness of industrial policy and limit a “race to the bottom;”
- Prepare the ground for some indices to guide policy and help with prioritization among various policy steps;
- Suggest ways of moving from plurilateral agreements towards multilateral, inclusive frameworks; and
- Initiate regional or international cooperative schemes for addressing the above.

## 3.1. Reorientation of Industrial Policy: From Hard to Soft Options and Encouraging Investment

The main difference between IM and EP policies could broadly be described in terms of market restriction applied in the former case, and support or facilitation policies in the latter. To simplify further, IM was used to augment the demand available to domestic producers by limiting competitive pressure on them. In contrast, EP was used to shift the domestic supply curve (expand supply) by reducing the costs of domestic operations and removing constraints faced by domestic producers. The ongoing changes in economic conditions suggest a need to focus more on supply enhancement policies.

The IM policy tends to inhibit incentives towards improving competitiveness, unless specific efforts are made to support innovation or an increase in productivity. In a world with growing international economic interlinkages and supply chains, industrial policies that focus on easing the conditions for doing business, enhancing supply capacities, promoting efficiencies, and reaping externalities are much more likely to be effective in the present, competition-oriented environment. It is also important to bear in mind that in a competitive market, restrictive policies do not lead to increased competitiveness.

Both empirical and practical experience have validated the expectation that system-building and coordination-enhancing policies, or so-called “soft” policies promoting a number of interlinked activities with a horizontal impact, are likely to have a relatively larger reach and impact. In comparison, the scope of impact will be much smaller for activities focusing on specific products through policy restrictions—i.e. “hard” policies such as tariffs, quotas, or

even subsidies that may be “vertical” or product-specific in their approach. Furthermore, policy-makers face difficulties in determining the “right” or “correct” level of hard industrial policy. In addition, there is some evidence to show that in general countries do not follow “good” policies or good practices when resorting to such intervention (Kuntze and Moerenhout 2013; Altenburg 2011). On the other hand, there is considerable work suggesting that with soft policies the development momentum is faster when clusters or chains of interlinked diverse production activities are enabled in any economy.<sup>24</sup>

Harrison and Rodriguez-Clair’s (2009) large survey of the literature on industrial policy shows that instead of “hard policies,” it may be better to focus on “soft policies,” including those which enable different stakeholders to collaborate on steps that increase productivity. Furthermore, while structured in terms of the traditional hard/soft paradigm, their conclusions could also be seen as being in line with a conception of industrial policy linked to investment policies and opportunities. They show that:

- Industrial policy is likely to be more successful with investment rather than trade;
- If investment promotion measures are part of a larger effort for technological upgrading, the policies are likely to be more effective;
- What you protect matters (for example, it is better to focus on activities where there is latent comparative advantage); and
- Increasing exposure to competition and trade raises the possibility of success (Aghion et al. 2012; Du et al. 2014).<sup>25</sup>

The importance of a wide scope for industrial policies and a shift away from hard policies is also described by Salazar-Xirinachs et al. (2014, 20): “The use of top-down planning mechanisms and selective tariff measures in support of infant firms has, over the years, given way to a more decentralized approach, using an expanded range of support measures and instruments which aim to build clusters and linkages.”

Among their important conclusions, Salazar-Xirinachs et al. also emphasize that for effective industrial policies, trade reforms should be combined with policies such as improving infrastructure, education and training, enterprise development, entrepreneurship, innovation, and finance, and social policies. Therefore, even when a specific sector—including a technology-intensive or knowledge-intensive sector with dynamic growth opportunities—is to

be promoted through vertical policies, such effort should be accompanied with:

- Systemic improvements and efficiency enhancing policies;
- The development of institutions which help collaborative efforts and timely implementation of policies; and
- The use of facilitating policies rather than restrictive policies.

An important point to mention with respect to these different policies is that for less developed countries it is difficult to implement soft policies due to their capacity constraints. Furthermore, tariffs are a source of revenue to them. These countries may consider moving in a time bound manner from hard to soft policies as they become more and more industrialized and acquire capabilities to effectively manage and implement soft policies. Assistance of various forms that may alter their information and capacity constraints becomes important. This point is discussed below in more detail.

### 3.2. The Importance of Prioritization and Good Governance

The above considerations are basic guideposts for effective industrial policy, but the relevant policies cover a large number of possible policy options, which would be confusing to both policy-makers and business. Thus, a set of significant steps could reassure business and guide policy-makers. First, portals for sharing information and assisting those seeking financial resources for business could be created.<sup>26</sup> The issue of availability of adequate finance is crucial in the process of development. Where it is difficult to borrow for industrial investment, a key role for policy is to provide or facilitate access to long-term or venture capital funding through national, regional, or global collaborative initiatives. Second, the main principles used for policy-making should be clearly specified, so that investment could take place based on an understanding of the likely direction and evolution of policy content. Third, it is useful to “prioritize” among the various policy steps to identify the key components that will be crucial for effectiveness and pave the way for better performance over time.<sup>27</sup> Within the priority list for LICs, particular importance should be given to implementing policies that focus on improving domestic conditions and coordination capabilities between the public and private sector to create an environment that both enables investment and enhances the efficiency of its operations.

<sup>24</sup> See for example, Naudé (2010).

<sup>25</sup> Naudé (2010, 10) states that, “A difficulty with the conclusion that the weak empirical relationship between protective measures and economic growth implies that infant industry protection has been unsuccessful, is that protection frequently is not used as IP. Indeed, tariffs and quotas are often not adopted for strategic purposes to foster a latent comparative advantage, but rather to generate either government income or to protect special interests.”

<sup>26</sup> Due to lack of full information, there is a failure of the capital markets leading to insufficient funding (Budzinski and Schmidt 2006), making a case for venture capital funds or direct long-term lending by development banks (Deraniyagala 2001; Budzinski and Schmidt 2006).

<sup>27</sup> Guadagno (2015) and Ramdoo (2015) show that low middle-income economies and LDCs must prioritize among policies.

In this context, it is also worth emphasizing the principles encompassing “good governance” because they both facilitate operations and provide confidence. These include transparency, timeliness of decision-making and informing business entities, simplification of procedures, single-window administration, incrementally raising the exposure of domestic producers to markets and competition, establishing coordinating mechanisms among government and business, and creating a means to review policy decisions through an established process.

### 3.3. International Cooperation on Information Sharing

Since developing countries in general have several information gaps and capacity constraints, it is useful to set up an international cooperative approach to gather information and insights based on case studies and the experience of nations in addressing specific issues. This would be essential for relevant insights and the applicability of policy options.

Another important factor is to recognize the differences between economies with respect to the policies used to achieve the same broad aim. Take, for instance, the likely differences in policies aiming at upgrading technological capacities. As mentioned, high-income countries (HICs) and upper-middle-income countries (UMICs) use industrial policies for the main purpose of generating innovation-driven growth. HICs focus on innovation to maintain economic dominance and long-term competitiveness, whereas UMICs do so to escape the middle-income trap and facilitate local supplier capabilities.

As well as case studies, actual experience in addressing specific issues would also be important. Under circumstances in which the operational conditions in global markets keep evolving, it is worthwhile to organize discussions among some countries with experience in addressing certain issues and others that are in the process of seeking solutions for those matters.

In addition, there is a tendency towards the increased use of public-private partnerships (PPPs) to supplement the efforts of various industrial policies. Policy steps need to be identified to increase the effectiveness of PPPs. A starting point for this would be to implement more widely existing models or even develop a framework (or model) for PPP agreements in specific sectors, based on the successful implementation of PPPs in comparable countries. The ongoing practices of regional development banks may be of particular relevance in this context.

Moreover, the overlap between policies for meeting important objectives is another area of cooperation in information sharing. Industrial policies focus on improving competitiveness, facilitating business and investment operations, and building technological capabilities to develop dynamic advantages. It is useful to identify if there is any overlap of the key policy steps that address each of these objectives. Independent work has taken place in these areas and indices of competitiveness (World Economic Forum 2014) and innovation (Dutta et al. 2015) have been developed, together with a list of important factors that determine the ease of doing business (World Bank 2014). Identifying overlapping factors will give rise to an industrial policy mix that could have a large impact.

Finally, countries do not sustain the same bundle of industrial policies as they develop. It would be important to track the type of industrial policies implemented by countries in different income categories, ranging from low-income to high-income economies, as well as the transition to new policy frameworks.

### 3.4. Arguments for Less Disciplines and Constraints in International Agreements

Singh and Jose (2015a) show that a broad range of policies are used to achieve the objectives of industrial policy, of which the most important include subsidization, local content requirements, and the facilitation of both R&D and operating conditions for business.<sup>28</sup> Many of these policies are subject to disciplines agreed internationally, such as under the WTO. However, as explained by Singh and Jose (2015b), the operational constraints imposed by these disciplines are significantly lower than at first appearance, because of various flexibilities and different levels of disciplines operating for developed, developing, and least developed economies contained within the agreements. Similarly, Guadagno (2015) and Ramdoo (2015) show that lower-middle-income countries (LMICs) and least developed countries (LDCs) do not adequately use the policy space available to implement industrial policies.

Another relevant aspect is that in the WTO, very few of the policies are subject to prohibitions and most complaints have to show that there is an “adverse effect” on trade of the complaining member. These complaints are addressed through the dispute settlement process, which allows time for re-examining the policies and, in certain cases, results in more flexibility than initially presumed.

The arguments highlighting constraints imposed by legal systems are not that policy avenues for development are closed, but that policies that were freely available earlier are now curbed by the rules of legal agreements such as those governed by the WTO.

<sup>28</sup> Industrial policy includes a whole range of initiatives through macroeconomic policies, subsidies, tariffs, non-tariff measures including standards or licensing requirements, regulatory requirements/exemptions, local content requirements or policies favouring local content, tax policy including tax preference, government procurement, state ownership and operations, intellectual property rights regime, infrastructure policy, energy policies, price controls, specific environmental policies, establishment of internal markets, competition policy, research strategy and innovation stimulus, encouraging entrepreneurship and the provision of risk capital, skill development and training, and cluster generation and promotion.

It is not that policy options are not available at all. In fact, the WTO has been in operation since 1995, and its predecessor the GATT since 1948. During this period, including post-1995, developing countries have used the available policy toolbox to achieve various objectives linked to industrial policy. Thus, policies to generate development schemes are available, though not necessarily with the same flexibility that was available to developed economies when they were growing or others in the second half of the 20th century. In this context, it is worth noting that Article III of GATT 1947 prohibited the use of local content, except for the exception provided for government procurement.

There are two ways of approaching this issue of policies curbed by the WTO. One is to consider which policies are used more frequently. Another is to consider which policies are relatively more constrained by the legal agreements. The overlap between these two would enlighten on the priorities that are most pertinent in seeking a change in the legal regime.

**Table 3: Industrial Policies and Constraints in International Legal Agreements**

<b>Policies</b>	<b>Prohibited Policies</b>	<b>Not Prohibited but could be challenged for “adverse effects”</b>	<b>Freely allowed</b>
<b>Subsidies</b>	Export subsidies to industrial products, with some flexibilities allowed for specified developing countries	Domestic subsidies	General subsidies; subsidies to small scale enterprises
<b>Local content</b>	Prohibited, with some exceptions		Local content through government procurement provided it is not linked to domestic content subsidy; local content for services
<b>Trade Restrictions</b>	Tariffs beyond bound rate, and quantitative trade restrictions—both with several exceptions allowed under various provisions of the WTO, including, for example, safeguards and the criteria specified in Article XX	Exceptions to the prohibitions could be challenged under dispute settlement if the relevant conditions that justify their use are not met	
<b>Intellectual Property Rights</b>		Disciplines to be maintained, with some flexibilities	LDCs are exempt
<b>Trade Facilitation</b>			Allowed
<b>Various aspects of good governance such as transparency, timely decisions, exposing firms to competition</b>			Allowed

Table 3 shows that the two main policies in a special category (those prohibited and without much flexibility options) are export subsidies to industry and local content requirements (LCRs). Among these two, LCRs are still possible under certain specified conditions such as for services, or in the case of goods through government procurement by non-members of the WTO Agreement on Government Procurement (GPA). These measures are reported to have been used quite widely across both developed and developing countries for reasons such as rejuvenating domestic production, acquiring technological capabilities, and building links with regional or global value chains.<sup>29</sup> There have been arguments for both lower and higher disciplines for LCRs. Therefore, one may examine the case for altering the disciplines that cover LCRs, including combining enhanced disciplines with greater flexibility in the rules.

Yet another criterion for considering possible flexibilities arises if some important global objective (such as environmental targets) is to be met through industrial policy but the requirements under legal agreements such as the WTO constrain the implementation of the relevant policy. In this context, it is noteworthy that a specified form of “green” subsidy was earlier subject to flexibility under a provision that lapsed after a few years.<sup>30</sup>

In the case of certain environmental objectives, legal interpretations of the WTO Agreement have to some extent expanded the scope of flexibilities. However, as shown by Bohanes (2015), there is limited scope for reaching extensive flexibilities through interpretations in the dispute settlement system.

We consider below the issue of greater flexibility for these two types of policies.

### 3.5. Flexibility for Local Content Requirements and Green Subsidies

#### 3.5.1. Local content requirements

Under the present disciplines applicable to prohibition on LCRs, each of them has to be individually challenged through the dispute settlement process at the WTO, requiring a long and tedious process. One option is to reassert the prohibition of LCRs which exists in the Agreement on Trade-Related Investment Measures (TRIMs), but that would simply be a reassertion of the prevailing disciplines themselves. The underlying conditions or operational situation would not change.

The above concern is exacerbated by the fact that there are certain policies, as indicated above, which are not covered by the prohibition on LCRs, including LCRs in relation to services as well as government procurement for goods by

non-members of the GPA.<sup>31</sup> There could be an effort to close these gaps and have a comprehensive ban on LCRs. However, three issues are relevant in this context.

- (a) There is evidence of large-scale reliance on LCRs, even by developed countries. One reason for this is that countries in general have started considering LCRs as a useful policy tool that has a direct impact on their policy objective of reviving or enhancing domestic production, capacity, jobs, and technological capabilities.
- (b) Those who use LCRs often overlook how it increases costs incurred by affected producers. Thus, to address this disincentive, policy-makers often provide financial support or subsidy to the producer. Even then, LCR policies are normally not effective in small economies/markets or in conditions with a lack of underlying infrastructure, facilities, or skills.
- (c) LCR prohibition is a desirable policy because it aims to ensure a level playing field between domestic products and foreign products (national treatment). The prohibition presumes that LCRs cause an adverse effect on importers.

The main policy consideration is how to assess these three aspects and reach a conclusion that takes account of them in a reasonable way.

Point (c) would require all loopholes to be closed and a “full” level playing field be provided in the rules. That is one of the options that could be considered. Relevant in this context is the proposal by Cimino et al. (2014) who provide a framework for higher disciplines for LCRs to close several loopholes.

If that loophole is not closed, then, in effect, investment in large economies will be drawn, even with LCRs, because such economies can provide significant subsidies and their domestic markets are relatively more attractive. This is unlikely for small economies or those with inadequate skills or infrastructure. Such an asymmetric response among large and small economies is likely to fuel a sense of unfairness already felt by the latter, enhancing the discomfort of a number of poorer countries which consider that new disciplines can be equivalent to “kicking away the ladder” from their reach after those that have attained higher levels of development have used the policy flexibility. In this situation, especially if the loopholes that exist in more than one agreement are not being closed, it would be appropriate to consider whether there are any alternative options to satisfactorily deal with the disciplines applicable to LCRs.

The concern with LCRs and their proliferation is not a new phenomenon. LCRs were prohibited under Article III of GATT 1947, but a number of countries were using them when the Uruguay Round negotiations (1986–1994) were under way. Rather than addressing them one by one through dispute settlement in the 1990s, the WTO TRIMs Agreement was

<sup>29</sup> For example, see Hufbauer and Schott (2013). Another example is the ongoing effort at addressing the question of food stockholding in the context of food security. Since this is an issue already being addressed by the Doha Round, we do not consider it further here.

<sup>30</sup> This refers to Article 8 of the WTO Agreement on Subsidies and Countervailing Measures (McInerney 2001).

food security. Since this is an issue already being addressed by the Doha Round, we do not consider it further here.

<sup>31</sup> Members of the GPA can use government procurement to apply LCRs for goods from non-members of the Agreement.

negotiated to phase them out within a specified transition period. Today, it is clear that something akin to the TRIMs Agreement needs to be re-enacted. However, it is also evident that stronger sets of rules and monitoring provided under the TRIMs Agreement are not proving to be practically effective, because a large number of LCRs are still used in different countries (Hufbauer et al. 2013).

The discussion below considers some possible ideas for conditional flexibility and stricter discipline, and then provides some precedence for a similar effort in the context of another policy measure, namely safeguards.

Regarding flexibilities, an option could be that the rules be changed to explicitly allow the establishment of time limited training programmes for local producers with the possibility of apprenticeship (including as suppliers) as a necessary complement to investment, accompanied by a time limited local content requirement as an additional option for upgrading domestic capacities. This would be similar to the concept of “benefit sharing” for the host country beyond the benefits directly arising from the investment itself, a concept that is now beginning to be emphasized in the context of investment agreements.

Furthermore, at a time when countries want to acquire greater capacity in technologies that address adverse climate effects, or technologies that will potentially become platforms for economic activity in the future (e.g. digital platforms), it could be worthwhile for overall social benefit to assist them in this endeavour. In this regard, it could be useful to consider steps to augment domestic capacities in developing countries that seek investment or technologies in specific areas with large-scale impact vis-à-vis climate issues, or technology platforms that will facilitate moving towards new forms of conducting business, for example the digital economy.

The legal criterion spelling out the details of such policies aiming at conditional flexibility could be based on some established principle under the WTO. Consideration could be given as to whether the disciplines for LCRs should be the same as most policies addressed in the WTO, namely that instead of prohibition they be considered as permissible unless they cause “adverse effects.” This thought could be combined with some discipline in terms of a presumption of “adverse effect” due to the LCR, if:

- The share of the country in the global exports or imports of the product concerned is above an agreed threshold (akin to Article 27.6 of SCM); or
- The extent of LCR is above a specified threshold figure. The pre-agreed threshold figure for the LCR level in that context would be like a *de minimis* level below which no action is taken against the measure.

Further, in order to give greater certainty and quick effect to the disciplines embodied in these conditions, a fast track dispute settlement process and implementation of the decision to phase-out an LCR could be agreed.

Another possibility could be to have exceptions for LCRs as provided under Article 27 of the WTO Agreement on Subsidies and Countervailing Measures (ASCM). The conditions there include the possibility of a phase-out period, with a review to consider an extension of the agreed period for flexibility. However, such flexibility could be provided only until the global trade share of these countries is below a specified threshold level, such as in Articles 27.5 and 27.6 of ASCM.

There is a view that existing disciplines should not be diluted because that would imply going contrary to the desired direction of increasing discipline. However, we have a precedent for changing the rules to combine flexibility and greater disciplines in another situation, namely the WTO Agreement on Safeguards. In the Uruguay Round, GATT contracting parties were concerned by the proliferation of voluntary export restraints (VERs) in place of safeguards. Safeguards were considered more difficult to use because they involved payment of compensation whenever they were used. Furthermore, when import quotas were used to implement safeguards (a commonly used method) the rules for allocation of import quotas did not allow the importing country to focus more on those nations whose exports of the concerned product caused a larger threat to their domestic industry. The WTO Agreement on Safeguards includes deviations from accepted rules on allocating import quotas (Article 5.2(b)) and exceptions from providing compensation for limited time periods under specified conditions (Article 8.3). To balance this, it was agreed to prohibit VERs and similar measures (Article 11.1(b)).

### 3.5.2. Green subsidies

Another policy area often emphasized is the use of subsidies for addressing environmental effects, for which flexibilities can be sought under international agreements (Rodrik 2014). A case for providing flexibilities to environmental subsidies would be justified based on positive externalities to be addressed through such subsidies. Nonetheless, as Wu (2015) shows, the issue is complex and needs considerable analysis for the appropriate level and types of subsidies to be provided. Based on a detailed assessment, Wu suggests potential steps that could be considered for these subsidies.

## 3.6. Rising Levels of Disciplines in New Plurilateral Agreements

Plurilaterals with a large coverage, such as the TPP for example, will result in an increase in operational constraints on industrial policy relative to those that currently exist under the WTO. This has three implications described below. The emerging regulatory constraints limit the flexibility of nations in terms of the policies that could be used for their objectives (Ciuriak and Singh 2015). To some extent, this is mitigated by the fact that in a world with increasing reliance on supply chains and growing focus on improving competitiveness, facilitation policies rather than restrictive policies become more relevant. For many facilitation policies, the legal constraints do not become binding even with the evolving regulatory regimes through the mega-regionals.

The trend of stronger disciplines will continue to build upon the existing mega-regionals, with similar or enhanced disciplines in later plurilateral agreements resulting in less flexibility for policy use. Nonetheless, this new set of emerging disciplines is unlikely to constrain soft policies or system-wide policies. Likewise, subsidies are unlikely to be covered by additional disciplines within plurilateral agreements, with the exception of fisheries subsidies and export subsidies to agriculture by large economies. In light of this, industrial policies in the future may be focused on those areas that are not constrained by new and emerging trade agreements.

First, the available policy flexibilities will be affected for tariffs, intellectual property rights, processes that affect standards (including standards emphasizing sustainable development and social standards), state-owned enterprises, and electronic data transfers. Since many new technologies and development options involve data transfers, the potential effects of constraints in this area are very large. In view of the likely adverse effect on development potential on a relatively wide scale, it is important to address the specific concerns in this area in a coordinated manner through national, regional, and international initiatives. These should combine development funding, capacity improvements, and even working on trade rules that will enable more inclusive participation of poorer nations in global markets, as well as areas of policy flexibilities that may be provided for specified periods and under pre-agreed conditions to widen the scope of available policy response for those who may find it more difficult to distribute subsidies to assist their producers. Thus, a more creative effort at building a level playing field would be required to address the concerns of poorer nations as well as small and medium-sized enterprises.<sup>32</sup>

Second, the new plurilateral agreements will result in higher environmental, social, and other standards for the products sold in the markets covered by members of these agreements, with lead firms in these markets emphasizing such standards throughout their global value chains.<sup>33</sup> This potentially implies a growth of private standards. In view of the importance of these standards in supply chains, suppliers who are unable to meet the requirements will face market access constraints, even if they are otherwise cost-competitive. This means that better information needs to be gathered. Diverse standards should converge towards a similar basis or platform—a process that will require international efforts involving both policy-makers and business. Further, a road map should be prepared for capacity augmentation and the development of methods which allow for larger acceptance of conformity of standards in one country within the markets of others, especially

major markets. Particular attention needs to be given to small-scale industries. In this regard, the regional centres (presented in section 4.1 below) could collect information on efforts in various countries to meet private standards and upgrade capacities of small-scale industries. That information could be relevant for others as well.<sup>34</sup> Based on these steps, a wider set of disciplines could ultimately be incorporated for private standards within WTO.

Third, given the major importance of an inclusive multilateral system for sustaining development and mitigating disputes, it is important to seek avenues to move from limited coverage agreements to the multilateral system. It would be important to combine accommodation of higher disciplines with long transition periods, selected flexibilities, interim reviews to consider possible changes, and threshold levels for changes in flexibilities available. Some major and developing economies with an interest in this aspect could get together to discuss an Agreement to Facilitate Inclusive Roadmap for Sustainable Trade (AFIRST). Possible options could include the models included in the Telecommunications Services Reference Paper and Article 27 of the ASCM. Article 27 combines a higher discipline with a long transition period and the possibility of review, *de minimis* threshold levels, flexibilities for some countries based on clear criteria, and also other criteria to determine when the available flexibilities will not be provided.

### 3.7. Arguments for More Disciplines and Constraints in International Agreements

In tandem with the view that greater flexibilities within international agreements need to be considered, there is also a perception that greater disciplines, in certain cases, are required. These include more disciplines for anti-dumping and countervailing measures and fisheries subsidies.<sup>35</sup> Using the above criteria in the context of the need for greater flexibilities, namely a large incidence or impact of policy as well as a need to address key externalities of global importance, both of these policy areas qualify as deserving important emphasis for additional disciplines.

Additional disciplines in these two areas are arising or being considered in bilateral or plurilateral agreements. Major economies could get together in an open-ended group to examine the possibility of an international initiative on combining the additional disciplines arising in different bilateral and/or plurilateral agreements into the basis of an agreement with a larger membership. Such an agreement could be implemented in a similar manner to the Information Technology Agreement—i.e. with additional disciplines adopted by the members of the larger agreement but

<sup>32</sup> This topic is addressed by the E15 Expert Group on Digital Trade and the overlap incorporating industrial policies and development issues can be referred to in the policy options paper.

<sup>33</sup> In this context, an important development has been the recent G7 June 2015 Declaration's section on Responsible Supply Chains, as described in section 2.2.5 supra.

<sup>34</sup> An example is the ongoing effort by the Quality Council of India and its growing links with standards organizations in various countries and regions, with a particular focus on small-scale industries and step-wise upgrading of capacities to sequentially improve standards capabilities to reach international levels in a specified time period (see also Kantha 2015).

<sup>35</sup> Export subsidies and other export competition measures for agriculture is another such area but movement in this regard is moving forward in WTO negotiations.

benefits made available to all others (on a most-favoured-nation (MFN) basis). In the case of certain parts where benefits are difficult to provide on an MFN basis, such as aspects of anti-dumping policies, a transition period with review could be considered to make it more manageable.

### **3.8. The Importance of Lead Firms in Supply Chains**

Since the new framework of global interlinkages involves supply chains, new insights are focusing on the role of lead firms in these chains. In the E15 Expert Group on Global Value Chains (GVCs) there is a recommendation to establish a platform that facilitates the interaction between governments and business on issues relating to GVCs (see 4.1 below). This platform could also include a specific segment on improving the effectiveness of industrial policies within the framework of GVCs, with the direct involvement of lead firms. Most of this discussion is likely to focus on facilitating policies, and determining criteria to make adjustments that address the concerns of various countries when seeking “landing zones” in any future multilateral or plurilateral negotiation on this issue.

# 4. Next Steps: Policy Recommendations

Based on the analysis presented *supra*, this section provides recommendations for action over the short to medium term.<sup>36</sup> While these policy options summarize the main ideas, the discussion in the paper provides examples of policy steps that could be part of a more detailed consideration for implementing these options.

## 4.1. Regional and International Cooperative Initiatives

- a) Regional Centres of Excellence and complementary/additional platforms

*Short to medium term*

**Policy Option 1:** Establish Regional Centres of Excellence where policy-makers and business representatives from selected countries convene to discuss/address pre-identified practical policy concerns. Such an initiative should ideally be under the auspices of a development bank so that useful ideas could be implemented quickly with financial backing. These centres would be of particular use for smaller economies, which generally have limited resources to address the host of issues and to collect the information needed to create a stronger economy. These efforts should devise differentiated policy options for countries at different stages of development (e.g. LICs, MICs, HICs).

To complement the above option, in the Regional Centres of Excellence, develop an information base to help countries determine priority among various policy steps required. Focus could be on building systems to better collaborate/coordinate interaction between government and the private sector, establishing mechanisms to implement vendor development programmes co-developed by multinational enterprises/regional development banks, or designing support policies to enable domestic producers to climb the value chain/complexity chain and upgrade from original equipment manufacturing (OEM) to original brand manufacturing (OBM). This initiative could rely also on the GVC Platform suggested by the E15 Expert Group on GVCs.<sup>37</sup>

**Policy Option 2:** Develop a framework or model for PPP

agreements in specific sectors, which has been successfully implemented in comparable countries. Using this model, identify those policies with greatest impact and interlinkages with other policies, and consider the gaps that need to be addressed in the national policy framework. To the extent that some regional or global development institutions are already implementing these initiatives, the lessons from such experience should be assessed for insights and facilitating steps that can be used more easily and at a much wider scale. The PPPs relevant for economies at different levels of income would differ. For instance, in the case of upper-MICs, PPPs may be needed to promote public-private joint R&D to break into emerging sectors, and for LICs, they may focus more on capacity upgrading and building infrastructure.<sup>38</sup>

**Policy Option 3:** In the regional or global centres of excellence, identify a list of sunrise industries for stylized countries under different income categories, and the policy support chains relevant for those industries. This list of sunrise industries would chart the way for developing dynamic growth trajectories for countries in different income groups. To focus on this the policy-makers may:

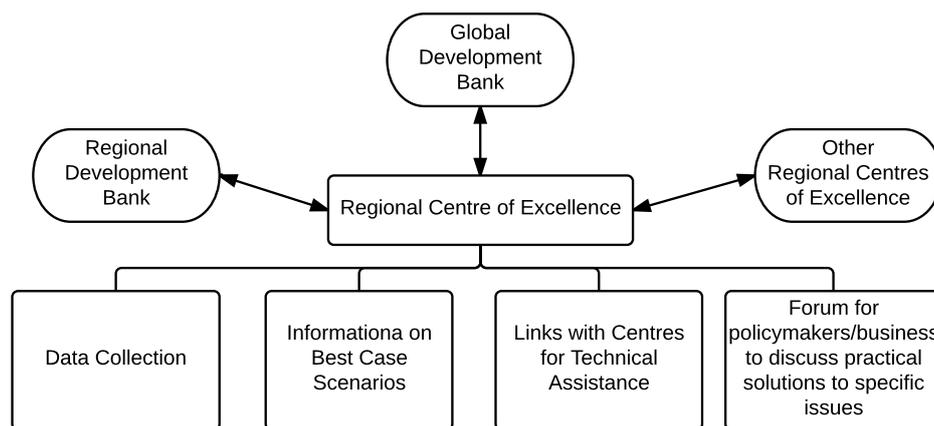
- Distinguish between investment which is focused on new activities or industries from those which support industries that are either old or in decline; and/or
- Identify steps to promote technological upgrading depending on the level of development and capacities prevailing within a nation.

**Policy Option 4:** Identify key common policy components among the factors that are emphasized for improving the ease of doing business, together with those considered in the indices on competitiveness and on innovation. Since there would be a substantial body of existing work in this area, it would be useful to compile best case scenarios and how specific constraints and problems were addressed in different situations. This information should be made available within a platform for discussion and suggestions for policy-makers and business to address specific and targeted issues.

b) Efforts linked to lead firms in supply chains: improving

<sup>38</sup> Regarding this last dimension, the E15 Expert Group on Trade, Finance and Development has put forward an option which, in view of strong informational asymmetries, calls on the development of mechanisms to strengthen the institutional and technical capacities of low-income country governments to negotiate and implement PPPs, with a special focus on infrastructure (Options for Trade, Finance, and Development: Getting the Institutions Right, policy option 12).

**Figure 2: Links and Tasks of the Regional Centre(s) of Excellence**



Source: Author

standards capacity for small-scale industry

*Short term*

**Policy Option 5:** Include in the GVC Platform to be established under the E15 Expert Group on GVCs the possibility of discussing the improved effectiveness of industrial policies, particularly involving lead firms in international supply chains. This discussion would harness synergies through participation of lead firms in common regional/international efforts and upgrading capacities using the resources and interaction envisaged under the recommendation on Regional Centres of Excellence.

*Short to medium term*

**Policy Option 6:** Special effort should be made to address the above issues for the small-scale sector, using case studies and collaborative initiatives through a common platform for this purpose. Such a platform could be part of the Regional Centres of Excellence. One example is the ongoing development of step-wise augmentation of capacities in India to eventually reach international standards through a five-step process.<sup>39</sup>

## 4.2. Flexibility in the WTO Agreement: Local Content and Global Objectives

a) Local content requirements

*Medium term*

**Policy Option 7:** WTO members could consider whether or not some flexibilities in legal regulatory conditions may be provided for LCRs, based on some specified threshold levels of income (or global trade share), below which the prohibition on LCRs need not be applied. Alternatively, the WTO's prohibition could be converted into a test based on "adverse effects" to be examined through the dispute settlement process, similar to the regulatory system for domestic subsidies.

**Policy Option 8:** Another option would be to use the framework for a plurilateral effort suggested by Cimino et al. (2014) to close the loopholes for legal provisions relating to LCRs. This agreement could combine stricter disciplines with some flexibilities, especially for those with a small presence in global trade for the product concerned.

b) Global objectives and global goods

*Medium term*

**Policy Option 9:** Begin a discussion on identifying a short list of global objectives or "global goods," for which agreement may be reached to exempt from legal constraints certain policies to achieve these global goods. Examples could include health-related objectives (e.g. efforts to address epidemics and major diseases), environmental sustainability objectives, public access to selected publically funded research, and food aid. To maintain the effectiveness of industrial policy, it would be useful to focus on a small number of specific issues that potentially have wide support. A good candidate for this would be revised rules for environmental subsidies.

<sup>39</sup> This refers to the ZED (Zero Effect Zero Defect) training model used by the Quality Council of India (2015).

**Policy Option 10:** Revisit international disciplines on environmental subsidies as follows.

- Expand the list of non-actionable subsidies to cover:<sup>40</sup>
  - Renewable energy infrastructure development and upgrades;
  - Feed-in-tariffs and demand/price guarantee schemes (w/o LCRs);
  - Consumer grants/rebates;
  - Off-grid renewable energy products.
- Alternative approaches beyond Article 8:
  - Balancing test (modelled on the “Green Box” in the Agreement on Agriculture);
  - Capped allowance on a list of environmentally beneficial subsidies (modelled on the “Green Box” in the Agreement on Agriculture);
  - Restrict countervailing duty actions against green goods, either through time and scope limitations, mandatory application of public interest test, and lesser duty rule.
- Expand special & differential treatment for developing countries:
  - Subsidies for off-grid renewable energy products, which could improve the quality of life for underserved rural and poor urban communities while achieving environmental gains;
  - LDCs may provide certain types of prohibited subsidies contingent upon implementation of structural conditions.

### 4.3. Disciplines in Plurilateral Agreements or the WTO on New Issues

*Short to medium term*

**Policy Option 11:** Major economies should engage as a group to identify the additional disciplines agreed in bilateral agreements with respect to fisheries subsidies and anti-dumping and countervailing measures, and try to use that as a basis to have an agreement with wider membership in the form of a WTO plurilateral with MFN benefits to non-members of the plurilateral agreements.

**Policy Option 12:** Develop frameworks for data transfer and privacy requirements with different issues of relevance pertaining to different types of data.<sup>42</sup> Training programmes linked to these requirements should be put in place, with coordination among industry associations regionally or among developed and developing countries.

**Policy Option 13:** Develop a new discussion mechanism within the WTO, delinked with any negotiations, to discuss new or increasingly significant matters such as behind the

border issues (logistics and regulatory policies) and across the border issues like standards consistency, business mobility, trade information, and e-business infrastructure. The discussion could also aim at managing situations arising due to digital trade and supply chain linkages that raise questions that go beyond the jurisdiction of any single WTO member.

### 4.4. Inclusiveness

#### a) Common framework for private standards

*Short to medium term*

**Policy Option 14:** Based on ongoing work in international institutions such as the ITC, World Bank, and UNFSS, develop a framework of key principles to bring greater conformity among major private standards. An initial effort could be made by developing this, for example, under a framework similar to the “Reference Paper” for Telecommunications Services within the WTO.

#### b) Roadmap for facilitating conformity assessment

*Short to medium term*

**Policy Option 15:** Prepare a roadmap for augmenting capacity and facilitating conformity assessment for standards in one country within the markets of another. This effort should go beyond bilateral mutual acceptance to a larger, multiple nation initiative. Models for such training implemented in developing countries, such as the ZED training module cited above (Quality Council of India 2015), and common initiatives with developed economies could be used to consider practical initiatives in this area.

**Policy Option 16:** Identify possible provisions within FTAs, including mega-FTAs, for adjustments that accommodate the objective of inclusiveness, especially with respect to conformity assessment.

#### c) Thresholds for expanding rules of origin in FTAs

*Medium term*

**Policy Option 17:** For rules of origin, all FTAs accounting for at least one-fifth of world trade should include LDCs as if they were members of that FTA. Once the FTA members account for two-thirds of world trade, the rules of origin should become multilateral—i.e. include all countries as if they were members of the FTA.

<sup>40</sup> The policy options paper of the E15 Task Force on Subsidies can be referred to (Rethinking Subsidy Disciplines for the Future). The first option recommends creating a category of narrowly defined non-actionable subsidies with clear boundaries, including subsidies to address climate change and similar environmental concerns. The paper then outlines options for establishing, monitoring, and resolving disputes that may arise on boundary issues.

<sup>41</sup> Bastable test deems an industrial policy subsidy to be worthwhile if the total costs of support are outweighed by the present discounted value of the benefits derived.

<sup>42</sup> See the policy option paper produced by the E15 Expert Group on Services, entitled Rethinking Services in a Changing World. Option 1 addresses the issue of establishing guidelines for regulating cross-border data flows, and outlines a series of concrete steps that could be taken in that direction in the short term.

d) Agreement to Facilitate Inclusive Roadmap for Sustainable Trade (AFIRST)

*Medium to long term*

**Policy Option 18:** Begin discussion on an Agreement to Facilitate Inclusive Roadmap for Sustainable Trade. Existing models aimed at finding compromise and voluntary acceptance of disciplines and desirable principles, as well as ways of enabling countries to upgrade capacities to meet higher standards, could provide a starting point for this discussion. This recommendation develops the idea that at a time when global trade regulation is being increasingly fragmented, there is a need to build a broad and consistent framework for the facilitation of inclusive conditions to move the trade system towards a regime where all can participate more effectively, and have the possibility of larger opportunities for growth and development through trade and investment.

#### 4.5. Concluding Note

The world economy has evolved to an extent few could have anticipated a generation or so ago. Technological change and growing interlinkages among economies have brought to the fore important new factors of competitiveness in the processes of integration and development. With production and distribution networks increasingly organized in global and regional value chains, a growing overlap has developed among policy issues, including services and goods as well as investment and the expanded scope of trade measures behind the border. In this interlinked world, experience suggests that restrictive policies are less successful in achieving the objectives of sustained enhancement of domestic productive capacity and competitiveness.

The gaps that new industrial policy aims to address, in high- to low-income economies, are more system or institution oriented while involving sector or industry specific issues as well. They also include global and domestic objectives reflecting social and environmental concerns. Coordinated policy efforts have to be made for each of these initiatives, with soft or horizontal approaches having a greater impact. To enhance the effectiveness of such policies (or processes), considerable effort needs to be directed at information and institution building as well as improved coordination and interaction between government and the private sector. These cooperative efforts must be conducted at the national, regional, and international level to enable countries, especially the less developed, to move positively on a sustainable development path.

In this context, the policy options outlined in this paper, which are offered to policy-makers and interested stakeholders, provide a set of practical recommendations for action over the short to medium term. They seek to address some of the key challenges and opportunities raised by the resurgence of industrial policies and their overlap with the global trade and investment systems. One of the pillars of these proposals is the establishment of Regional Centres of Excellence where policy-makers and business representatives could convene to discuss and address practical policy concerns, and where mechanisms to bridge information gaps and capacity constraints could be developed.

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The papers commissioned for the E15 Expert Group on New Industrial Policy and the Trade System can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>Regional and international cooperative efforts</b>					
<b>1. Establish Regional Centres of Excellence to facilitate the identification and implementation of effective industrial policies.</b>	Short to Medium Term	The World Bank, regional development banks, and regional UN agencies conduct some of this activity.	Activities need to be conceptualized and implemented in a comprehensive manner, and the missing elements addressed.	<p>Focus on building systems to better collaborate/coordinate interaction between policy-makers and business from selected countries to work on solutions for pre-identified practical policy concerns.</p> <p>Develop an information base to help countries prioritize among the various policy steps to achieve stated objectives.</p> <p>Implement vendor development programmes co-developed by multinational enterprise, or support policies to enable domestic producers to upgrade within value chains.</p>	Regional Centres of Excellence; global and regional development banks; governments; and business.
<b>2. Develop sector-based frameworks or models for public-private partnership (PPP) agreements.</b>	Short to Medium Term	Several models exist. Developing governments may face problems in realizing the benefits of PPPs due to weak capacities to design, negotiate, implement, and evaluate PPPs.	To the extent that these initiatives are already being implemented by regional or global development institutions, lessons should be assessed for insights and facilitating steps should be identified for wider use.	<p>The PPP models should seek to identify interlinkages between policies, gaps, and areas of high impact.</p> <p>The model should differ for countries at different levels of development.</p>	Same as above.

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>3. Identify a list of “sunrise” industries and the policy support chains relevant for those industries.</b>	Short to Medium Term	Historical experience shows that innovative efforts to upgrade technologies could from time to time lead to disruptive changes in the operating conditions of international economic interaction. Sunrise industries are best able to embody the new technology paradigms needed for this type of disruptive change.	There is a general view on coverage of sunrise industries, but more specific and targeted thought is needed to draw links between countries at different levels of income/resources availability with likely sunrise industries/ activities.  Another issue is to clarify what configuration and sequence of policies are relevant for these industries.	Identify a list of sunrise industries that would chart the way for developing a dynamic growth trajectory for countries in different income groups.  Policy-makers may: 1) Distinguish between investment which focuses on new industries vs. supporting sunset industries; 2) Identify steps to promote technological upgrading; and 3) Identify relative policy support chains.	Same as above.
<b>4. Identify common policy components to improve country rankings in: (i) ease of doing business, (ii) competitiveness, and (iii) innovation.</b>	Short to Medium Term	Intergovernmental organizations and regional banks have done considerable work in this area.	Need to identify relevant major policy steps to improve ranking in each of these indices. Identify policies that are common or have synergies for priority consideration.	After conducting the analyses, information and case studies should be made available through a platform, to promote discussion and suggestions for policy-makers and business on how to address the specific issues.	Same as above.
<b>5. Improve the effectiveness of industrial policies that focus on learning from lead firms in value chains.</b>	Short Term	Some <i>ad hoc</i> efforts are in place for such initiatives.	Given the increasing interlinkages between trade and investment due to GVCs, there is a need to focus on attracting and learning from lead firms.	Discussions could take place either through a GVC platform or the regional centres of excellence.	Regional Centres of Excellence / GVC platform; governments; business; international or regional institutions.

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>6. Build capacity of the small-scale sector to fulfil international/lead firm standards requirements.</b>	Short to Medium Term	To gain access in global markets, SMEs will have to increasingly fulfil more stringent regulatory/standards requirements set by international private standards.	Most donor-led projects focus on capacity building of local firms to fulfil national regulatory standards. To facilitate participation and upgrading within GVCs, it may be more worthwhile to prioritize capacity building projects meeting the needs of lead firms/international standards.	Establish regional platforms to develop and implement capacity building projects for SMEs to fulfil international/lead firm standards requirements.	Regional Centres of Excellence; governments; business; international or regional institutions.

#### Flexibility in the WTO Agreement: local content requirements and global objectives

<b>7 &amp; 8. Consider WTO flexibilities combined with greater disciplines for local content requirements (LCRs).</b>	Medium Term	Not much consideration has been given to this issue, even though LCRs are proliferating.	While LCRs are prohibited for goods under the WTO, several gaps remain. Stronger disciplines may need to be negotiated to close these gaps for segments such as LCRs in relation to services, and government procurement of goods by non-members of the Government Procurement Agreement.  In recognition of the large-scale use of LCRs, this may need to be combined with some support flexibilities, as was done in the case of Safeguards negotiations in the Uruguay Round.	Consider changes based on: a) Agreeing on a specified threshold level of income or global trade share (e.g. Art. 27.4 of ASCM); b) Converting prohibition into an “adverse effects” test, similar to the regulatory system for domestic subsidies; c) Creating a new plurilateral agreement to close loopholes for LCR provisions, but with flexibilities.	WTO members  Governments in multilateral, plurilateral, or bilateral negotiations.
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Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>9. Identify a short list of global objectives (global goods) that warrant a loosening of legal constraints.</b>	Medium Term	There is general agreement on several objectives considered significant at the global level and which may require special consideration/treatment under existing trade rules.	Discussion should begin on identifying and agreeing on a short list of global objectives, for example those reflected in mega-regionals that will affect conditions for global trade and investment.	a) Focus on limited number of issues that have potential for wide support. b) Consider changes in rules that may be needed for achieving: environmental sustainability objectives; easier access to select publically funded research; health-related objectives; and, food aid.	Same as above.
<b>10. Revisit international disciplines on environmental subsidies.</b>	Medium Term	Article 8 of WTO's Agreement on Subsidies and Countervailing Measures (ASCM) had provided exemptions from actions against certain subsidies, including environmental subsidies. This Article expired in 2000.	Certain environmental support policies may trigger positive externalities in relation to climate change and other global commons. It may be worthwhile to consider the reintroduction of a category of non-actionable subsidies.	1) Expand the list of non-actionable subsidies under the ASCM; 2) Develop alternative approaches beyond Article 8 of the ASCM; 3) Expand special and differential treatment for developing countries.	WTO members
<b>Disciplines in plurilateral agreements or the WTO on new issues</b>					
<b>11. Consolidate specific disciplines agreed through bilateral agreements and consider enlarging their scope to become multilateral.</b>	Short to Medium Term	A number of bilateral / plurilateral agreements have developed disciplines in certain areas of common concern, e.g. fisheries subsidies.	These remain with limited coverage and thus with limited impact.	Consolidate disciplines related to fisheries subsidies, and anti-dumping and countervailing measures for environmental objectives, or limit the scope of arbitrary policies in the area of contingent protection.  Consider either providing MFN treatment to plurilateral agreements or enabling more countries to subscribe to the new disciplines.	WTO members  Governments in plurilateral / multilateral negotiations.

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
12. <b>Develop frameworks for data transfer and privacy requirements.</b>	Short to Medium Term	Different definitions and practices prevail, causing fragmentation.	Increasing extent of fragmentation in trade regulatory mechanisms could potentially be disruptive More is needed to cover this gap.	<p>The new plurilateral frameworks should take into consideration the implications of rules for various types of data transfers (e.g. B2B, B2C), and develop different disciplines (some more flexible than others), if the underlying features are not the same.</p> <p>Provide capacity building for developing countries to successfully meet the requirements of the new frameworks. Training programmes should be put in place in coordination with industry associations.</p>	Governments, business, and civil society

<b>Policy Options</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>13. Develop new discussion mechanisms at the WTO to address significant emerging matters related to both behind the border and across the border issues.</b>	Short to Medium Term	Discussions on certain issues have been/are being conducted, but in general there is hesitancy to deal with new issues.	There is no accepted mechanism under which discussions are kept completely separate from whatever might be in the negotiated agenda.	<p>Ensure discussions and the mechanisms used for them are delinked from existing negotiations</p> <p>Discussions could cover (i) behind the border issues such as relevant policies to improve effectiveness of logistics, and coherence of regulations; and (ii) across the border issues such as consistency of standards, business mobility, trade information and e-business infrastructure.</p> <p>Discussions could also aim to develop mechanisms that would help manage conflicts, which often go beyond the jurisdiction of any single WTO member. Examples of focus areas include conflicts arising due to problems in digital trade or constraints in developing supply chain linkages.</p>	WTO members

Policy Options	Timescale	Current Status	Gap	Steps	Parties involved
<b>Inclusiveness</b>					
<b>14. Develop a framework of key principles to bring greater conformity among major private standards.</b>	Short to Medium Term	Unlike public standards set by governments, private standards are currently not subject to WTO disciplines.	There is no consensus within the WTO on how and whether to address private standards that have large market coverage.  Special efforts in this context may be required also following the G7 Declaration on “Responsible Supply Chains.”	Discuss possible frameworks to bring greater transparency and coherence among private standards with industry-wide presence and impact.  The WTO Reference Paper for Telecommunications could be used as a potential model to kick-off a process for developing principles for private standards.	WTO members  Governments in multilateral, plurilateral or bilateral negotiations.
<b>15. Prepare a roadmap for augmenting capacity to facilitate the conformity assessment of standards.</b>	Short to Medium Term	<i>Ad hoc</i> efforts and policies prevail in this area.	No well-considered roadmap that considers a wider range of countries and evolving standards that affect market access conditions.	Examine different bilateral / plurilateral mutual acceptance agreements to consider possible common / coherent larger multi-nation initiative.  Another possibility is to use existing successful training modules, e.g. the ZED training module aimed at SMEs in developing countries.	Governments in regional or bilateral negotiations, international institutions, and think tanks.
<b>16. Identify provisions in free trade agreements (FTAs) that need adjustment so as to fulfil the objective of inclusiveness.</b>	Short to Medium Term	WTO+ disciplines negotiated through mega-FTAs will impose additional constraints on policy use, particularly for the small economies that are not members of the negotiations / agreement.	The plurilaterals do not consider their impact on non-members.	Specific ideas should be developed for the possibility of increasing inclusiveness (decreasing exclusion) of non-member countries, especially low-income economies.	Same as above.

<b>Policy Options</b>	<b>Timescale</b>	<b>Current Status</b>	<b>Gap</b>	<b>Steps</b>	<b>Parties involved</b>
<b>17. Establish thresholds for expanding rules of origin in FTAs.</b>	Medium Term	Very little thought is given to the multilateralization of plurilateral disciplines that are not inclusive for non-member countries.	The large impact of mega-regionals implies that a special effort is required to examine ways to increase inclusiveness or decrease exclusionary features.	<p>For FTAs accounting for at least one-fifth of world trade, the rules of origin should allow LDCs to be treated in effect as members of the FTA.</p> <p>For FTAs accounting for two-thirds of world trade, the rules of origin should be same as in the WTO.</p>	Governments in regional or bilateral negotiations.
<b>18. Initiate discussion on an Agreement to Facilitate Inclusive Roadmap for Sustainable Trade (AFIRST).</b>	Medium to Long Term	No such agreement exists.	As global trade regulations become increasingly fragmented, there is a need to build a large consistent framework that facilitates inclusive conditions.	Build on successful models that facilitate compromise and the voluntary acceptance of disciplines and desirable principles. This needs to be supplemented with capacity building activities that help developing countries meet higher standards.	Governments, business, and civil society.

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Established in 1996, ICTSD's mission is to ensure that trade and investment policy and frameworks advance sustainable development in the global economy.



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OF THE WORLD

# Trade and Innovation: Policy Options for a New Innovation Landscape

Policy Options Paper



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# Trade and Innovation: Policy Options for a New Innovation Landscape

John M. Curtis  
on behalf of the E15 Expert Group on Trade and Innovation

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Trade and Innovation. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15 Initiative and authored by group members. John M. Curtis was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:  
[www.e15initiative.org](http://www.e15initiative.org)

# Abstract

The interconnection between trade and innovation is one of mutual reinforcement and this two-way relationship has become the subject of growing attention among experts and practitioners. With the innovation process increasingly organized in global networks and value chains across borders, innovation, trade, investment and industrial policies are now more closely intertwined and their interface is in need of a fresh look. Many countries are actively pursuing ambitious innovation policies to boost their competitiveness. Research and development activities, both public and private, are becoming more transnational in nature. At the same time, societies across continents are in growing need of deploying and adapting new technologies and building innovative capacities to effectively address sustainable development challenges, including the environment, food security and public health. Yet innovation affects countries at separate rungs on the development ladder differently. Distinct policy tools (and their application) intended to encourage innovation and facilitate its dissemination

and absorption will be appropriate in diverse situations. Against this background, the present paper assesses whether current trade regulatory frameworks, in particular WTO agreements, adequately support innovation as a policy objective in the context of the knowledge economy and the digital environment. It then converges around recommendations in six broad categories of possible policy change: global rules on digital trade; new rules to expand the movement of people to pursue innovation opportunities; revised rules on internationally agreed and targeted research subsidies in areas of recognized global public concern; a concerted move to establish international standard-setting on the basis of open and global collaboration; an internationally coordinated approach to trade secrets; and steps to improve innovation-related data collection. It concludes by submitting different approaches to innovation and trade system reform and by identifying a set of research gaps that deserve further analysis at the intersection between innovation, trade and sustainable development.

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Abbreviations	
ABST	Agreement on Access to Basic Science and Technology
ASCM	Agreement on Subsidies and Countervailing Measures
BERD	business enterprise expenditure on research and development
DETA	Digital Economy Multilateral Trade Agreement
EPA	Economic Partnership Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GIN	global innovation network
GPA	Government Procurement Agreement
IEL	international economic law
ITA	Information Technology Agreement
LDC	least developed country
MFN	most favoured nation
MNE	multinational enterprise
OECD	Organisation for Economic Co-operation and Development
R&D	research and development
RCEP	Regional Comprehensive Economic Partnership
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UNESCO	United Nations Educational, Scientific and Cultural Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

# Executive Summary

The relationship between trade and innovation has become the subject of growing attention among development experts, policy-makers and business executives. Globalization and digital technologies have had a profound impact on the global innovation landscape. With the innovation process increasingly organized in global networks and value chains across borders, innovation, trade, investment and industrial policies are now more closely intertwined and their interface is in need of a fresh look.

The E15 Expert Group on Trade and Innovation, which was co-convened by ICTSD and The Evian Group@IMD in partnership with the World Economic Forum, examined the interface between international trade and innovation. The central task was to determine whether current trade regulatory frameworks, in particular WTO agreements, adequately support innovation as a policy objective. To the extent that “choke points” could be identified that appear to limit the international flow of knowledge, technology, business practices and people, the group addressed the question of what policy options could be envisaged in the medium to long term to better facilitate these flows. The experts also identified a set of research gaps that deserve further analysis at the intersection between innovation, trade and sustainable development.

## Innovation and the Trading System

New dynamics regarding innovation as a critical constituent of sustainable development have emerged as a result of globalization. Three important trends are briefly reviewed in the paper as background to the policy options: the emergence of global innovation networks (GINs); the growing need to address public goods at the global level; and mounting interest in new forms of industrial policy.

The interconnection between trade and innovation is one of mutual reinforcement. “Trade rules, regimes, and flows provide some of the necessary inputs to innovative activities. On the other hand, inventions, new processes, goods, services, and intangibles benefit from global markets to increase sales, scalability, efficiency, profitability, productivity, and skills” (Benavente 2014). This two-way process is extremely complex to frame and incorporate in multilateral trade and investment rules. Trade liberalization and investment flows contribute to technology diffusion and innovation. On the other hand, the strengthening of national innovation capabilities, which can often rely on discriminatory policies, improves a country’s ability to engage in and benefit from the international trade system.

Domestic innovation-related policies and measures span a wide range of WTO rules and disciplines. There is no single overarching WTO agreement that deals with innovation, but rather a variety of agreements that influence innovation activities such as those on subsidies, intellectual property, services, technical barriers to trade, investment measures and government procurement. The multilateral trading system, through these agreements, clearly has an impact on innovation-related policies and decisions by public and private economic actors on how and where to invest in innovation.

## Innovation and Trade-Related Policy Options

The expert dialogue converged around six broad categories of possible policy change that can be set out on a preliminary basis for broader discussion. These categories, which include ten medium to long-term policy options, are: global rules on digital trade; new rules to expand the movement of people to pursue innovation opportunities; revised rules on internationally agreed, targeted, and coordinated research subsidies in areas of recognized global public concern; a concerted move to establish international standard-setting on the basis of open and collaboration rather than through nation-centric considerations; an internationally coordinated approach to trade secrets; and steps to improve innovation-related data collection. The Expert Group also discussed the effects on innovation of intellectual property rights, with an emphasis on patents and particularly on the TRIPS Agreement. However, there was no consensus on whether any modifications were needed or practically feasible at this stage to enhance the TRIPS Agreement’s contribution to stimulate innovation globally.

### *Digital Trade*

Policy change to cover digital trade across borders can conceivably proceed in two ways. First, it can be incremental by building on the principles of existing international trade agreements. A medium-term option is thus to set out clarified and expanded provisions in future trade agreements, particularly in the WTO, to cover all aspects of digital trade based on existing rules and procedures. Second, an ambitious and entirely new international arrangement could be created to cover all aspects of digital trade. Such a Digital Economy Trade Agreement, which would deal with “deeper integration” issues related to digital trade, could be established as a stand-alone agreement or under the WTO, possibly initiated on a plurilateral basis to be multilateralized in due course.

### *Movement of People: Innovation Networks*

A second set of policy options involves removing on a concerted basis barriers hindering the movement of technically and entrepreneurially skilled persons and research professionals across borders to pursue innovation opportunities. An ambitious approach worth exploring would be a system that would link skilled workers together in an “innovation zone” in which countries would agree to allow longer-term work visas that would be valid in all participating countries. This proposal could build on expanded Mode 4 commitments in the General Agreement on Trade in Services (GATS).

### *Subsidies and Public Grants*

A third area of possible reform in support of innovation relates to expanding the policy space for governments and the private sector to explicitly permit subsidies to address agreed and targeted global public policy objectives such as, for example, the development of essential medicines, water management, agricultural productivity, waste disposal, energy conservation and climate change. The first recommendation would be to clarify the relationship between public research grants and permissible subsidies under the WTO Agreement on Subsidies and Countervailing Measures. A more ambitious longer-term option would be to establish an Agreement on Access to Basic Science and Technology, whose fundamental notion would be to preserve and enhance the global commons in science and technology without unduly restricting private rights in commercial technologies.

### *Technical Barriers to Trade and Standardization*

The WTO Agreement on Technical Barriers to Trade could be revised to better facilitate innovation. The concept of standardization, in particular, could be updated to reflect the existence of *a priori* globally open, transparent and bottom-up standards to promote global public goods. WTO processes in this area could be reformed so as to explicitly acknowledge the concept of standardization beyond nation-centric and intergovernmental arrangements.

### *Trade Secrets*

A fifth area of possible policy change relates specifically to trade secrets. National laws and practices with respect to trade secrets vary greatly and it could be of value to bring consistency to the treatment of trade secrets into the international trade legal framework, possibly through a non-binding understanding or in a stand-alone arrangement.

### *Measurement of Trade and Innovation*

A final recommendation relates to the importance of improved measurement of trade-related aspects of innovation to better inform the negotiating process in the WTO (and other relevant international organizations). Efforts towards a better measurement are challenged by the fragmentation of fora, approaches, classifications, taxonomies and databases. International organizations such as the WTO and WIPO could encourage national governments to develop surveys in collaboration with the private sector in order to provide useful information concerning all aspects of innovation and trade.

## Way Forward

The Expert Group in its deliberations and exploratory work examined many issues, some of them more mature for policy consideration than others. While there was no consensus on the preferred route for promoting innovation in the context of the existing international trade system, four different approaches to innovation and trade system reform are conceivable: an incremental approach within or beyond the WTO; and, a more ambitious approach within or beyond the WTO. In view of the current deadlock in the Doha negotiations at the WTO, it can be argued that an incremental approach is the most viable option at the multilateral level. However, there is a growing tension between what the multilateral trade system can contribute, particularly in terms of timely decisions, and what is required to facilitate innovation on a global scale.

The cross-cutting nature of innovation and its multifaceted character prevailed in and permeated the discussions of the Expert Group. Important efforts were made in identifying research gaps that deserve further analysis and reflection at the intersection between innovation, trade and Sustainable Development Goals. There was an emphasis on establishing better understanding of the underlying issues as well as the need to carry out further work on a number of the questions examined by the group. These issues fell into four broad thematic areas: policy frameworks, innovation systems and best practices; the international trading system and plurilateral processes; attention to small and medium-sized enterprises; and, intellectual property-related questions.

There are well established institutions that could play a role in leading this consensus and bridge-building process around the policy options presented in the paper as well as carrying forward discussion and analysis of the issues and research gaps identified by the group.

# Introduction

In the context of the E15Initiative, a group of experts examined the interface between trade and innovation with the objective of identifying challenges and opportunities facing the global trading system in the innovation landscape of the early 21<sup>st</sup> century. A set of knowledge gaps and policy options were identified during the discussions, many of which could serve as guideposts to facilitate change in the world trade regime and to steer it in a manner more supportive of the promotion of global innovation for sustainable development.<sup>1</sup>

The relationship between trade and innovation has been the subject of growing attention on the part of policy-makers and others in the private and non-governmental sectors. Existing agreements under the WTO, such as the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) or the General Agreement on Trade in Services (GATS), as well as most recent regional and bilateral trade agreements, touch both directly and indirectly on various aspects of trade and innovation. However, these agreements are often perceived to be suboptimal in terms of generating significant incentives for innovation.

There is a clear link between trade and innovation—with innovation broadly perceived as the transformation of an invention into marketable products and services, the development of new business processes and methods of organization, and the absorption, adaptation and dissemination of novel technologies and know-how. The relationship is one of mutual reinforcement: trade can serve to shape innovation and innovation can shape trade.

The central task of the Expert Group, co-convened by ICTSD and The Evian Group@IMD in partnership with the World Economic Forum, was thus to determine whether the existing system of trade rules is either promoting or simply accommodating innovation worldwide. To the extent that “choke points” could be identified that appear to limit the international flow of knowledge, technology, business practices and people, this paper addresses the question of what policy options could be envisaged or recommended in the medium to long term to better facilitate these flows—thereby encouraging global efforts to further innovation for sustainable development.

The significant changes that the global innovation landscape is witnessing are important to bear in mind. Economic activities are increasingly services-oriented and organized into global or regional value chains, which are becoming ever-more prominent characteristics of the world economy. Research and development activities also are becoming more transnational in nature. At the same time, many countries are actively pursuing ambitious innovation policies to boost their competitiveness. Yet, innovation affects countries differently. Distinct policy tools (and their application) intended to encourage innovation will be appropriate in diverse situations. Policies and experiences in advanced industrialized countries and emerging economies may not be well adapted, for example, to countries where access to global markets and technology flows is more limited and where absorptive and innovative capacities are weaker. Thus, the harmonization of rules, regulations and standards is challenging to achieve in a world economy whose operations and practices are changing rapidly and are increasingly differentiated.

<sup>1</sup> The issues and policy options outlined in this paper are inspired from group deliberations that took place between 2013-14 and draw freely on think pieces, referenced below, commissioned by the E15Initiative.

# 1. Global Innovation and the Trading System

## 1.1. The Growing Importance of Innovation

Acknowledgement of the role of innovation has come relatively late in mainstream economics and still remains relatively undigested despite its growing status as a focal point for developmental policies and for growth of the firm. One important reason for this certainly stems from the fact that innovation is hard to measure. Economists are more comfortable with assessing the growth impact of labour, capital and productivity than coming to grips with the complex and multidimensional notion of innovation. The concept remains to some extent a “black box” around which economists circle, inferring what is going on inside through more tangible evidence and indicators, such as R&D spending, patent filings, scientific publications and the development of new products and services.

There are, however, some stylized facts that are worth noting. First, the various indicators associated with innovation are poorly correlated. While intellectual property rights can be important for incentivizing innovation in a number of sectors, they are not necessarily synonymous with it; stronger levels of intellectual property protection could even be detrimental to innovation in other sectors. Second, just as firms are highly heterogeneous, so are returns to patents and other forms of intellectual property. The impact of the vast bulk of intellectual property rights recognized by national authorities, and enshrined under TRIPS and other international intellectual property agreements, remain open to debate in terms of increased innovation. Third, the role of R&D has evolved. While most research is done in the public sphere and the majority of development is done in the corporate sphere, this division has evolved as an increasing number of governments directly or indirectly support business R&D (OECD 2013). There is also a growing priority given to the commercialization of publicly funded R&D. This can result in an imbalance in the determination of research priorities and the allocation of resources in a manner detrimental to the research that ultimately feeds into supporting development efforts and to responding to longer term public policy objectives and needs. Fourth, the innovation gains from imitation can be significant, particularly for newcomer innovators.

Conceptualizing innovation is thus a challenge. This policy options paper follows the definition outlined in the OECD Oslo Manual 2005, which has also been adopted by other international organizations such as UNESCO and the World Intellectual Property Organization (WIPO). “An innovation is the implementation of a new or significantly

improved product (good or service), or process, a new marketing method, or a new organizational method in business practices, workplace organization or external relations” (OECD and Eurostat 2005, 46). Moreover, “a new or improved product is implemented when it is introduced on the market. New processes, marketing methods or organizational methods are implemented when they are brought into actual use in the firm’s operations” (OECD and Eurostat 2005, 47). While R&D is an essential component of innovation, it is only one part of a broader process of discovery, transformation, adaptation and disruption.

The Oslo Manual concept of innovation has a number of advantages (Benavente 2014). The definition does not focus exclusively on technological processes and products. It recognizes that low-tech sectors—which are less R&D intensive and more prevalent in emerging and developing countries—are also subject to innovation. Moreover, it applies not only to goods, services and intellectual property, but also to other intangibles, such as “soft” innovations in business and organizational methods, including firm-level training, testing, marketing and design. Finally, as quoted above, the requirement of “commercialization” is embedded in the definition through the qualification of the word “implementation.”

## 1.2. Globalization and the Changing Innovation Landscape

Globalization and digital technologies have had a profound impact on the global innovation landscape. At the same time, innovation has become a crucial aspect of the development process, as policy-makers in both high and low-income countries increasingly see the development and adoption of advanced technologies, know-how and new business methods as key to stimulating productivity, competitiveness, employment and growth. Innovation as a policy objective has thus become a priority for many governments in advanced, emerging and developing economies, increasingly pursued through measures that support private and public R&D as well as incentives for the transfer of knowledge and technology through a mix of industrial, investment and trade policies.

New dynamics regarding innovation as a driver for sustainable development have emerged as a result of globalization. For the purpose of this paper, three trends are briefly outlined: the emergence of global innovation networks (GINs); the growing need to address public goods at the global level such as environmental protection; and mounting interest in new forms of industrial policy. All are perceived as a means of acquiring capabilities and expanding absorptive capacities in science, technology and innovation, not least in developing countries.<sup>2</sup>

<sup>2</sup> This section draws heavily on Maskus (2015) and Maskus and Saggi (2013).

### 1.2.1. The emergence of global innovation networks

The expansion of global innovation networks has mirrored the evolution of transnational production networks and value chains that increasingly characterize world trade and investment in terms of specialization and geographic dispersion. The resultant cross-border trade in value-added embodies the flow of tasks rather than products, “thus providing a direct link to the innovation literature, for which business activities along supply chains, such as R&D, design, production, marketing, and the provision of services, are the crucial elements” (Benavente 2014).

In the narrow sense, [the concept of GINs] refers to the establishment within a multinational enterprise (MNE) of one or more R&D affiliate facilities at different locations around the world, along with the consequent R&D management, specialization decisions, and exchange of information among them and the parent company. This concept, along with explaining the determinants of R&D location choice and the anticipated efficiency gains, lies at the core of the business-economics literature on the globalization of innovation (Maskus and Saggi 2013).

More broadly, innovation networks incorporate many actors, including MNEs (which may collaborate in R&D), high-technology start-ups, universities and public research laboratories, venture capitalists, specialized technology brokers, standard-setting organizations, and government agencies. These networks emerge as different participants recognize the gains from research specialization and collaboration (for example, in licensing, public-private partnerships, and international research alliances). These broader networks have multiple commercial and public objectives, ranging from basic revenue to knowledge creation and the solution of global public problems requiring complex research investments (Maskus 2015).

Policy-makers in countries at all ladders of economic development have come to see the integration of their economy’s enterprises and institutions (e.g. universities, research centres, public laboratories) with GINs as a key driver of technology transfer, knowledge diffusion, local innovation, entrepreneurship and competitiveness. It is worth noting that private and public agents from emerging economies are playing a dramatically growing role in these global collaboration networks and that there is increasing international mobility of research professionals and knowledge workers across institutions and firms within these networks. In this context, even economies that are not following an explicit outward-oriented strategy of development have begun to pay much greater attention to GINs.

### 1.2.2. Innovation and public goods

Societies across continents are in growing need to deploy and adapt new technologies and build innovative capacities to effectively address sustainable development challenges. These include environmental sustainability (especially efforts targeted at climate change mitigation and adaptation but also the loss of natural habitats and biodiversity), energy efficiency, water management, waste disposal, agricultural productivity, food security, and public health.

Developing countries with narrow markets and more limited absorptive capacities are confronted with several barriers for the effective transfer and adaptation of technologies through imports. First, potential market demand for technologies, products or services that attend to problems of public interest might be insufficient to provide incentives for private R&D and innovation. Second, firms in developing countries might often lack the financial resources and technical capacities to acquire and adapt to local conditions available technologies, such as wastewater treatment, agricultural inputs or renewable power generation, which often require substantial capital investments. As Maskus (2015) concludes, specifically in the context of environmental protection and green technologies, “these dual market failures—inadequate innovation incentives and costly adaptation—call for policy intervention, the most direct and effective of which is likely to be direct subsidization.”

#### 1.2.3. Innovation and new industrial policy

Many innovation and development economists have come to advocate a new form of industrial policy that has gained growing influence and traction in policy circles. The theoretical foundation underpinning this approach can be found in the work of Hausmann and Rodrik (2002), who interpret economic development as a process of self-discovery.<sup>3</sup> The current debate and proposals on updated forms of industrial policy are less about market interventionism and more on technological innovation, productivity gaps, R&D, entrepreneurship, vertical specialization and agglomeration economies.

In the European Union, this new interpretation of industrial policy in the modern world economy has led to a proposal to implement a comprehensive package of policy instruments designed to engage in “smart specialization.” Another reason for which the attractiveness of new forms of industrial policy may expand is the perception that certain fast-emerging economies, in particular China, have succeeded in stimulating key industries through the application of a blend of such policy measures. This has added credence to the suggestion that well-designed industrial policies can improve competitiveness, facilitate the transfer of technologies, build innovative capacities and upgrade targeted economic sectors. As a result, many emerging countries may be inclined to follow variants of this prescription in which innovation is a core consideration. For low-income countries—often characterized by low flows

<sup>3</sup> According to Maskus (2015): “Their insight is that economic development is an uncertain process in that developing countries may not know what they may be good at producing in the early stages of industrialization or transformation into modern sectors. In this context, a period of “self-discovery” regarding domestic costs can be socially valuable for it permits potential entrepreneurs to experiment in areas of technology acquisition, adaptation, and innovation. However, such activities are likely to be readily imitated, implying that developing countries are likely to engage in too-little ex ante investment and entrepreneurship and too much fragmentation ex post. Their policy prescription is to encourage experimentation through both forms of appropriability [i.e. IP rights and market guarantees] (not necessarily strong IP rights) and public supports, while finding means of rationalizing and concentrating the production mix after the process matures.”

of international trade and investment and for which the trade system does not spur the kind of knowledge diffusion witnessed in middle income and emerging economies—this debate on industrial policy tools may be even more salient as they seek to develop a competitive and sustainable industrial base.

### 1.3. Multilateral Trade Regulatory Frameworks and Innovation

The central issue that this paper seeks to address is whether current trade regulatory frameworks, in particular WTO agreements, adequately support innovation as a policy objective in the context of the knowledge economy and the digital environment. In other words, what are the contributions and limitations of the current global trade system vis-à-vis innovation and how could it be improved? As the innovation process is increasingly organized in global networks and value chains across borders, innovation, trade, investment and industrial policies are now more closely intertwined and their interface is in need of a fresh look. The role of innovation was not at the forefront of government considerations when the WTO was established in 1994. Addressing its many dimensions in the present-day economic environment could trigger new responses that could help revitalize the multilateral trading system and reaffirm its relevance.

As described by Benavente (2014), “the interconnection between trade and innovation works both ways. Trade rules, regimes, and flows provide some of the necessary inputs to innovative activities. On the other hand, inventions, new processes, goods, services, and intangibles benefit from global markets to increase sales, scalability, efficiency, profitability, productivity, and skills” (See Kiriya (2012) for a review of the literature on the trade and innovation linkage).

This two-way process is extremely complex to frame and to incorporate in multilateral trade and investment rules. Trade liberalization and investment flows contribute to technology diffusion and innovation. Absorptive capacity in the recipient country also plays a key role in this process. Trade restrictions reduce the supply of intermediate goods to an economy, hampering productivity and technology diffusion. On the other hand, the strengthening of national innovation capabilities improves a country’s ability to engage in and benefit from the international trading system. National innovation policies, however, often rely on discrimination (e.g. the identification of “national champions” or localization). In this context, domestic policies and measures to promote innovation need to carefully balance effectiveness with the need to be consistent with multilateral trade rules and disciplines—while the multilateral regime needs to be sensitive to the policy space which might be required to promote innovation.

A key question is thus whether the existing set of WTO rules and disciplines optimally enable or limit today’s global drive to promote innovation. In this context, it is important to underline at the outset that there is no single overarching WTO agreement that deals with innovation, but

rather that there are a variety of agreements that influence innovation activities such as those on subsidies, intellectual property, services, and technical barriers to trade. As a result, the WTO lacks a holistic approach to this pressing contemporary policy challenge. Table 1 identifies a number of policies and measures that are commonly pursued by governments to promote innovation as well as the WTO agreements of relevance. It illustrates the point that innovation-related policies and measures span a wide range of WTO rules and disciplines.

**Table 1: Innovation-Related Domestic Policies and WTO Agreements**

Innovation-Related Policies and Measures	Relevant WTO Agreements <sup>1</sup>
Domestic R&D support and incentives (e.g. subsidies)	ASCM; Agreement on Agriculture
Protection and enforcement of intellectual property rights	TRIPS
Commercialization of publicly funded research	TRIPS
Transfer of technology and know-how	GATS; TRIMs; TRIPS
Government procurement	GATT; TRIMs; GPA
Technical Standards	GATT; TBT; SPS
Competition policy	TRIPS; TRIMs
Policy/regulatory frameworks and general infrastructure	Aid for Trade

The multilateral trade system, through the agreements listed in Table 1, clearly has an impact on innovation-related policies and decisions by public and private economic agents on how and where to invest in innovation. Moreover, in reviewing existing WTO instruments from the perspective of how they influence innovation globally, the current trade architecture was largely designed before the Internet revolution and the dramatic expansion of the digital environment.<sup>4</sup> These recent developments have already spurred a massive surge of innovative activity that has had spillover effects on many sectors of domestic economies and global markets.

At the WTO Public Forum in 2013 on “Expanding Trade through Innovation and the Digital Economy,” in which the E15 Expert Group on Trade and Innovation took an active role, Director General Roberto Azevêdo noted that “current WTO rules were conceived in a world with no Internet connection” and that the “multilateral trading system is in urgent need of update if it is to be relevant; if it is to stimulate innovation and development.” The remainder of this paper sets out a number of policy options and processes tailored toward these objectives.

<sup>4</sup> Relevant WTO Agreements cited in the table correspond to: ASCM (Agreement on Subsidies and Countervailing Measures); TRIPS (Trade-Related Aspects of Intellectual Property Rights); GATS (General Agreement on Trade in Services); GATT (General Agreement on Tariffs and Trade); TRIMs (Trade-Related Investment Measures); GPA (Government Procurement Agreement); TBT (Agreement on Technical Barriers to Trade); SPS (Agreement on the Application of Sanitary and Phytosanitary Measures).

<sup>5</sup> The WTO has a programme on e-commerce but it remains a sideshow in terms of rules making at the multilateral level. Most analysts believe that it is not properly designed to tackle the challenges posed by the digital revolution to global trade.

# 2. Innovation and Trade-Related Policy Options

This section focuses on possible policy options for improving international trade rules to promote innovation. The Expert Group examined a number of important issues and developments including the emergence of global innovation networks, the provision of public goods, private R&D support mechanisms, the relationship between intellectual property rights and innovation, and the possible crafting of new multilateral rules for digital trade.

Theoretical and empirical evidence undertaken in recent years suggests that at least six broad categories of possible policy change can be envisaged and set out on a preliminary basis for broader discussion and research. These aim to reduce or eliminate cross-border barriers and constraints on the development, movement, use and adoption of innovation. The six categories of medium to long-term policy options are: global rules on digital trade; new rules to expand the movement of skilled researchers, technicians and entrepreneurs to pursue innovation opportunities; revised rules on internationally agreed, targeted, and coordinated research subsidies by government agencies, universities and private sector facilities in areas of recognized global public concern which could be commercialized by private or public enterprises; a concerted move to establish international standard-setting on the basis of open and global collaboration rather than through nation-centric considerations; an internationally coordinated approach to trade secrets; and steps to improve innovation-related data collection and dissemination.

The Expert Group also did discuss the effects on innovation of intellectual property rights, with an emphasis on patents and particularly on the Agreement on Trade-Related Aspects of Intellectual Property Rights. A think piece was commissioned to this effect (Mercurio 2014). It concluded, among other matters, that there was a need to re-evaluate the purpose of the agreement, which, as drafted, does not consider innovation as its central objective. Mercurio also elaborated on the “need to reflect upon whether the current scope and the duration of patent protection is suitable for all industries, sectors and countries, or whether some differentiation would benefit innovation.”

However, there was no agreement in the Expert Group on whether any modifications were needed or practically feasible at this stage to enhance the TRIPS Agreement’s contribution to the global drive to stimulate innovation. This paper thus takes the view that any policy change in this area, if any, should be incremental, with perhaps more sensitivity to the sector-specific issues. An open discussion and debate should be encouraged and pursued to allow new ideas and proposals to flourish. Consequently, no policy options are set at this time, as further empirical work needs to be done on all aspects of intellectual property rights, including trade-related ones, from the perspective of their impact on innovation performance. An exception to this approach was the issue of trade secrets, as the group considered it useful to explore policy options in this specific area (see *infra* 3.5).

## 2.1. Digital Trade

Digital technologies are rapidly changing how societies in most parts of the world are conducting day-to-day business. However, the international legal framework, including global trade rules, is lagging behind in addressing these transformative developments.<sup>5</sup> As a result, possible policy options aimed at enhancing the economic benefits flowing from digital trade featured prominently in the group’s discussions.<sup>6</sup>

In this regard, it was recognized that some progress has been achieved internationally regarding the development of rules on one pervasive component of the digital economy—the Internet. The extraordinary development of the Internet through a bottom-up, decentralised and collaborative approach based on open standards has contributed to the emergence of an almost universal means of communication through which people, processes and data connect (Karachalios and McCabe 2013). This earlier, highly satisfactory development should bear lessons for the standardization process in the area of trade rules, which remains largely top-down and nation-centric.

<sup>6</sup> Burri (2013) remarks that “international economic law (IEL) has so far not reacted in a forward-looking manner to the digital revolution. If we look at the rules and commitments under the auspices of the World Trade Organization as the mainstay of IEL, no real advance whatsoever has been made since the Uruguay Round (1986–1994), and very little can be expected even in a successful post-Doha scenario. [...] The mega-regional trade deals of the Trans-Pacific Partnership (TPP) Agreement and the Transatlantic Trade and Investment Partnership (TTIP) Agreement [...] may offer some new approaches and more detailed and better structured templates for addressing digital trade. Yet, the claim remains valid that we are still only at the beginning of finding and defining an appropriate transnational and international regulatory framework governing digital technologies, and their associated opportunities and risks.”

Policy change to cover digital trade across borders can conceivably proceed in two ways. First, it can be incremental by building on the principles and provisions of existing international trade agreements. Second, an entirely new international arrangement could be created—possibly (but not necessarily) tied to the WTO or to other plurilateral trade arrangements—to cover all aspects of digital trade. The first option seems to be the preferred alternative of the community directly involved in trade negotiations. The question, however, remains: to what extent could this cautious approach be effective in a global economic environment increasingly impacted by the disruptions in business models generated by digital technologies?

### 2.1.1. Incremental policy option

With respect to the first option, future trade agreements could set out provisions to cover all online trade based on existing GATT/WTO rules, principles and procedures. These clarified or expanded provisions would touch on, for example, transparency regarding authorization for use and licensing, non-discrimination (both national treatment and most-favoured nation), uninhibited access to cross-border information flows, unrestricted foreign participation in the ICT sector, and increased international cooperation, including improved local and international assistance for increased digital literacy. In this context, those countries that agree to become part of this widened incremental agreement might also achieve consensus on permanently forbidding any form of tariff or other taxes on electronic commerce. The group also considered that extending the Information Technology Agreement (ITA) by expanding its product coverage and signatories, as well as further liberalizing computer-related and telecommunications services, should be priorities.<sup>7</sup>

Further, the Expert Group agreed that other barriers to digital trade such as the lack of access to technology distribution channels and information networks in areas as diverse as aviation, tourism and logistics should also be addressed, thereby decreasing the likelihood of unfair competition.

Overall, the risk of the gradual introduction and spread of a new generation of barriers to cross-border digital trade—whether this trade is classified as a service or as a good—has to be addressed in a trade negotiation setting. Issues such as privacy, intellectual property and security concerns could also be tackled in this context.

### 2.1.2. Ambitious policy option: create a Digital Economy Trade Agreement

The second and bolder policy option would be the development from scratch of a Digital Economy Multilateral Trade Agreement (DETA), which could either be part of the WTO or designed as a stand-alone agreement (Burri 2013). This entirely new agreement could tackle all known issues and barriers relating to digital trade. It would be a more ambitious and far-reaching agreement and would deal more comprehensively with “deeper integration” issues including privacy, cross border data, consumer protection and security matters than the incremental approach outlined above. It would also touch on data access, storage and use. Ideally, the agreement could feature a negative list approach (where all digital activities are liberalized unless explicitly provided otherwise) with specific negotiated exemptions. Initially, this bold digital trade policy reform initiative, if taken on by the trade community as a preferred option, could be initiated on a plurilateral basis to be multilateralized in due course.

**Policy Option 1:** Medium-term: Set out provisions in future trade agreements, particularly in the WTO, to cover all aspects of digital trade based on existing rules, principles and procedures.

**Policy Option 2:** Long-term: Establish a Digital Economy Trade Agreement either as a stand-alone agreement or under the WTO which would deal more comprehensively with “deeper integration” issues including privacy, cross border data, consumer protection, and security matters.

## 2.2. Movement of People: Innovation Networks

A second set of policy options involves removing on a concerted basis barriers hindering the movement of technically and entrepreneurially skilled persons and research professionals across borders to pursue innovation opportunities wherever these might present themselves. Maskus and Saggi (2013) propose a system that would link skilled workers together in an “innovation zone” in which countries would agree to allow longer-term work visas that would be valid in all participating countries.

Information, knowledge and know-how are usually transmitted by people; therefore, the group thought that increasing the ability of knowledge workers to move across international borders with maximum ease and without being tied to any particular employer for a temporary yet sufficiently long period of time—perhaps for a period of up to ten years—is a longer-term policy option worth exploring.

<sup>7</sup> The group considered that there might be a need to convene an E15 Expert Group specifically to examine this issue in a more comprehensive manner. For deeper analysis, the policy options produced in this series by the E15 Expert Group on the Digital Economy can be referred to.

<sup>8</sup> The expansion of the ITA (i.e. the ITA II), covering roughly 200 products that account for more than US\$1.3 trillion yearly in trade flows, was agreed upon on July 24 2015. This is an important achievement since it will gradually bring duty-free trade in information technology products impacting 7% of total global trade. This agreement illustrates how trade liberalization can still be accomplished at a sectoral level when there is a critical mass of willing partners in the WTO. The benefits of this plurilateral agreement will be extended to all WTO members on a most-favoured-nation (MFN) basis.

This expansion in the international mobility of skilled and research-oriented persons would raise the probability of shared knowledge and thus of increased innovation and creativity worldwide. The proposal to create an “innovation zone” of skilled workers with appropriate documentation would most likely start as a plurilateral agreement, but would be open to all countries—whether developed, emerging or least developed—to join this expanded trade arrangement that could build on Mode 4 of the General Agreement on Trade in Services.<sup>8</sup>

**Policy Option 3:** Medium-term: Expand GATS commitments to further encourage temporary mobility of skilled workers.

**Policy Option 4:** Long-term: Establish a plurilateral (but preferably broad and inclusive) “innovation zone” working through GATS within which skilled researchers and technical personnel would be able to migrate freely for up to ten years.

### 2.3. Subsidies and Public Grants

A third area of possible reform in support of innovation relates to expanding the policy space for governments and the private sector to explicitly permit subsidies to address agreed and targeted global public policy objectives such as, for example, the development of essential medicines and other public health matters as well as water management, waste disposal, agricultural productivity, food security, energy conservation and climate change. Publicly funded research grants could be carried out through public agencies, private-public partnerships, universities, foundations or private laboratories (which all work increasingly in collaboration and across multiple nations) with the aim, where appropriate, of commercializing the results of the “subsidized” research.

Although these types of public grants have not been challenged in a significant way under the Agreement on Subsidies and Countervailing Measures (ASCM) of the WTO (or similar provisions in regional and bilateral arrangements) nor under the Agreement on Government Procurement (GPA), as they have been considered pre-competitive and non-specific, they could become an issue of contention as such practices become more commonplace. Aspects of agricultural, biological or electronic research and a raft of other cutting-edge technologies such as nanotechnology, for example, all of which could end up—possibly under licence—in the hands of a private or state-owned enterprise, which could commercialize and sell the resulting output, could be facilitated under this policy option. As Maskus (2015) notes:

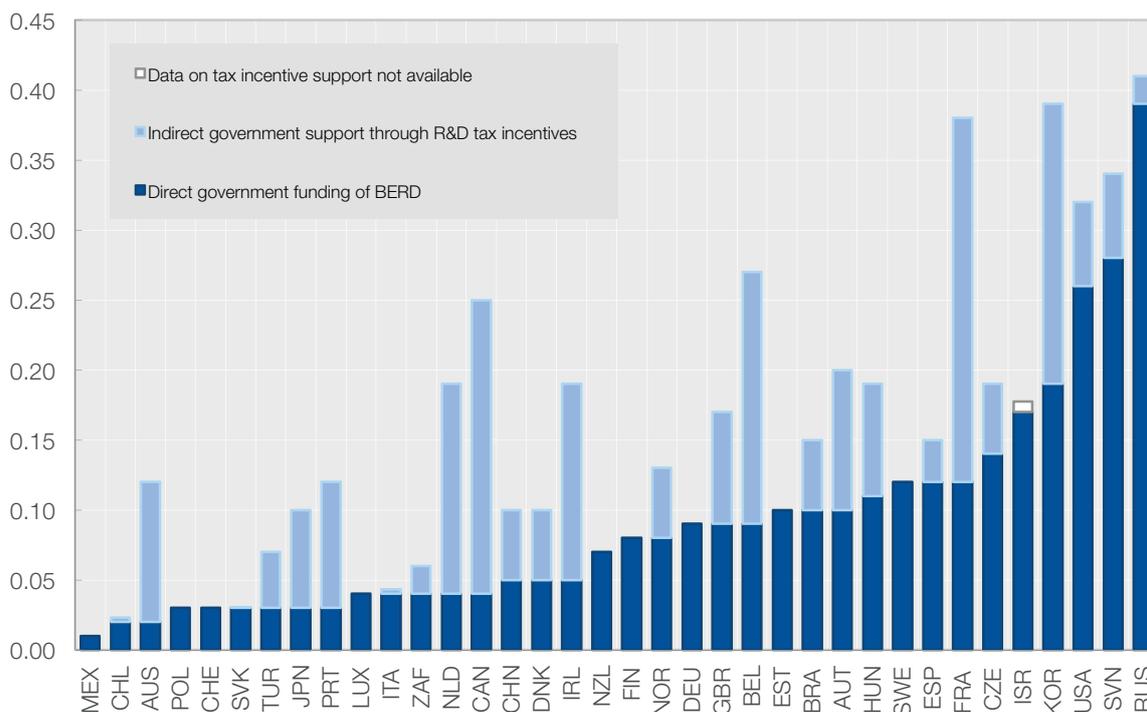
It is primarily this last form of subsidization [direct or indirect subsidies to business enterprise expenditure on research and development or BERD] that potentially raises issues of trade conflict. Where public resources pay for what might ordinarily be thought of as private product-development costs, particularly for entering foreign markets or expanding international market shares, there may be trade damages alleged. Research subsidies, in some circumstances, could act as a substitute domestic protection mechanism as tariffs are cut. They could also reduce a home-firm’s costs or raise its productivity, expanding its trade at the expense of other competitors. In extreme cases such subsidization could act to forestall entry by international competitors, potentially raising issues about whether it is anti-competitive. [...] There are reasons to anticipate increasing use of R&D supports going forward, whether to develop, attract and adapt climate change technologies, integrate domestic firms with GINs, or encourage localized specialization in technological activities.

The role of government in promoting this innovation-intensive activity through direct financial assistance, rather than through tax incentives or other measures, which is common in many countries (Figure 1), thus needs much clearer definition and space within a revised international legal framework. This could include, for example, an explicit exclusion from the WTO’s ASCM, particularly Article 8.2. An effective global specialization strategy could evolve from this more activist and targeted role for government, enabling both multinational enterprises and small businesses to participate with greater certainty in privately or publicly funded research activity.

Many countries appear to be developing policies and procedures to transfer technology from largely (or exclusively) public-supported research laboratories to private or other forms of commercial enterprises, particularly through the adoption and implementation of legislation based on the US Bayh-Dole Act (1980). A related recent development has been provisions in Economic Partnership Agreements (EPAs) negotiated by the European Union with several developing countries to facilitate the access of local researchers to public research grants and programmes in Europe (Spence 2009).<sup>9</sup> While by no means common or comprehensive as yet, these developments with respect to subsidies provided by the public sector to private or public agencies proposing to use advanced research for commercial ends suggests that substantive trade policy reform along the lines described above is possible and could be evidence of governments acting cooperatively with the private sector in the provision of global public goods in the broader public interest.

<sup>9</sup> “The agreement would need to pay attention to how the certification of skills acquired in different professions and in different countries is to be recognized by the members, though a strong tilt towards mutual recognition seems appropriate. Since the vehicle would be the GATS, presumably countries could reserve certain sensitive professions or perhaps enact safeguards” (Maskus and Saggi 2013).

**Figure 1: Direct Government Funding of Business R&D and Tax Incentives, 2011 (as a percentage of GDP)**



Source: OECD 2013

A more ambitious long-term option would be to establish an Agreement on Access to Basic Science and Technology (ABST) negotiated within the WTO. According to Maskus and Saggi (2013), the premise of such an agreement is the following:

The fundamental notion of an Agreement on Access to Basic Science and Technology ABST, meant to complement the global IPRs system, is to preserve and enhance the global commons in science and technology without unduly restricting private rights in commercial technologies. The mechanism would be to place into access pools the patented results of publicly funded research that develops knowledge capable of supporting applied science and R&D, especially in areas of common global concern, such as climate change and medicines. In essence, funding agencies in the participating nations would certify that, as a condition for receiving a grant in specific areas of primary science, universities and scientists must agree to place the resulting patents in common resource pools. These patents would then be available for license to all competent agents from other member countries under terms worked out in advance.

Maskus and Saggi further argue that such an agreement should reside at the WTO for several reasons including the fact that the WTO already manages many agreements on issues that are strongly interrelated with the transfer of scientific results (such as intellectual property, subsidies, standards and services) and that many of the essential WTO principles can be applied to an ABST.

**Policy Option 5:** Medium-term: Clarify, upon further study, the extent of subsidies or procurement disciplines on research grants (i.e. clarify the relationship between public research grants and permissible subsidies under the ASCM).

**Policy Option 6:** Long-term: Establish an Agreement on Access to Basic Science and Technology negotiated within the WTO.

#### 2.4. Technical Barriers to Trade and Standardization

The WTO Agreement on Technical Barriers to Trade (TBT) could be revised to better facilitate innovation. The WTO concept of standardization, in particular, could be updated to reflect the existence of a *priori* globally open, transparent and bottom-up standards to promote global public goods, which have led, for instance, to the extraordinary development of the Internet as noted in section 3.1 (Karachalios and McCabe 2013). Improvements in international standards and a more inclusive process in setting these standards on a less nation-centric basis would both reduce operational costs and promote more efficient innovation.

**Policy Option 7:** Medium-term: Update WTO concepts and definitions of standards so as to encompass more inclusiveness and openness.

**Policy Option 8:** Long-term: Reform WTO processes in this area so as to explicitly acknowledge the concept of standards and standardization beyond nation-centric and intergovernmental arrangements. This will require the direct recognition of associated contributions and standards from recognized and well established communities of experts, who cooperate, exchange information, build knowledge, and foster innovation on a global scale.

## 2.5. Trade Secrets

A fifth area of possible policy change relates specifically to trade secrets. National laws and practices with respect to trade secrets vary greatly. Trade secrets appear to be especially important to small and medium-sized businesses given their generally lower costs compared to more elaborate intellectual property processes involving patents, copyright, and other instruments.

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights was the first multilateral agreement to explicitly require member countries to provide protection for “undisclosed information,” or, as they are more commonly called, trade secrets. Article 39.2 of TRIPS defines a trade secret as information that (1) is secret; (2) has commercial value because it is secret; and (3) has been subject to reasonable steps to keep it secret. Following TRIPS, this definition has been widely adopted into national laws. Trade secrets cover three broad categories of information—(1) technical information; (2) confidential business information; and (3) know-how. Technical information concerns such matters as industrial processes, blueprints, and formulas, among other possibilities. Confidential business information typically includes customer lists (provided that they include truly non-public information), financial information, business plans, and similar types of non-public information on the operation of a business. Know-how includes information about methods, steps, and processes for achieving efficient results (Lippoldt and Schultz 2014).

Figure 2 highlights the continued diversity concerning trade secrets remaining in sample economies some 15 years after the TRIPS Agreement. “Overall, the international comparisons shown in the figure represent a challenging environment for business because consistent protections are not available for certain aspects of trade secrets. The

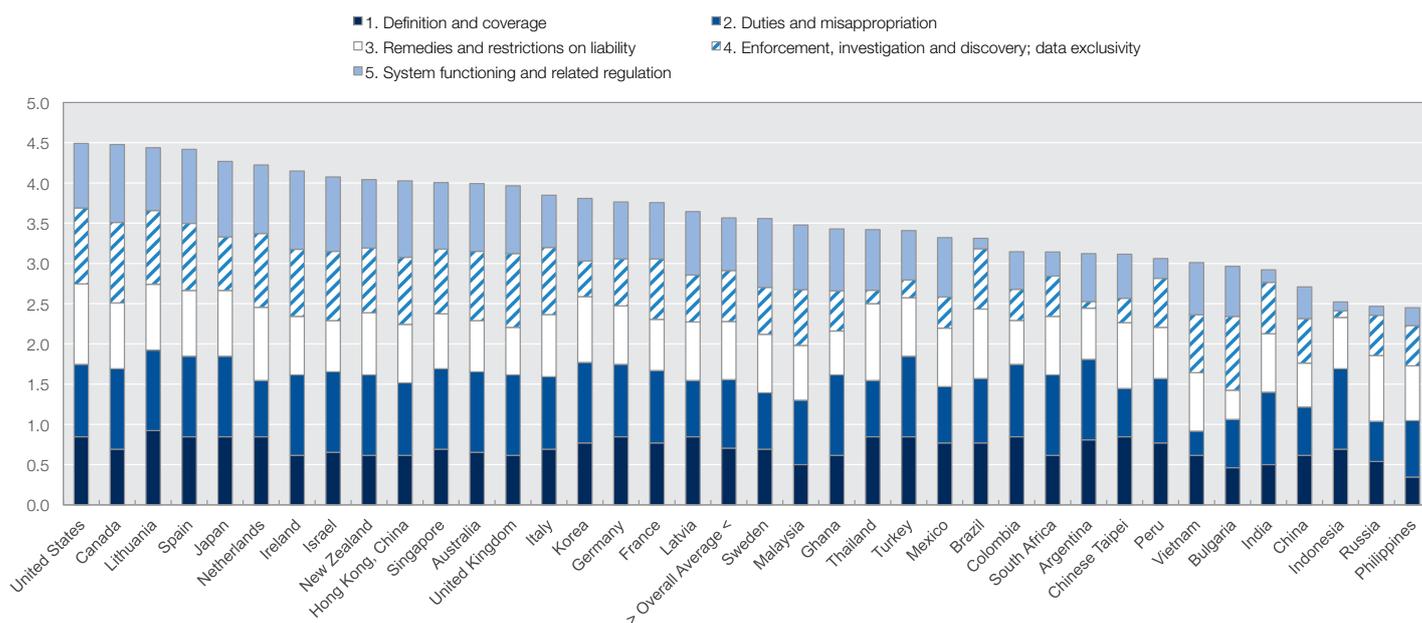
current variability of protection of trade secrets increases the complexity of management of business activities, and may discourage some investment in knowledge development and diffusion” (Lippoldt and Schultz 2014b).

As with other aspects of intellectual property rights protection, the central question regarding trade secrets is to achieve a balance. Intellectual property rights, including trade secrets, influence the behaviour of firms in terms of how they approach foreign markets, how they invest, how they train their personnel, and how and which technologies they use or share, if any. There are no absolutes in this area. The idea is to seek a basic system of trade secrets that functions, and which, on balance, promotes rather than constrains innovation and its dissemination—even if it cannot be measured satisfactorily due to secrecy requirements. This is the limited extent of what policy-makers can be asked to oversee and enforce.<sup>10</sup>

Figure 2 Trade Secrets Protection Index, 2010  
Bringing consistency to the treatment of trade secrets into the international trade legal framework, which, as mentioned, is challenged by the multiplicity of approaches in national laws, is an important policy option, the Group thought, for governments to consider as they attempt to create enabling conditions for innovation, commercialization and knowledge spillovers. Evidence suggests that some degree of trade secrets protection appears to facilitate a greater diffusion of information with an expanded circle of employees and business partners (Lippoldt and Schultz 2014b). Further research and dialogue on this matter are clearly required.

**Policy Option 9:** Long-term: Bring consistency to the treatment of trade secrets into the international trade legal framework possibly through a non-binding understanding or in a stand-alone arrangement that might eventually be employed as a starting point for consideration in a regional agreement or a plurilateral accord in the context of the

**Figure 2: Trade Secrets Protection Index, 2010**



Source: Lippoldt and Schultz 2014

<sup>10</sup> The Expert Group in deliberating on trade secrets did not consider the implications of Art. 39(3) of TRIPS dealing with undisclosed test or other data submitted to public authorities in the case of regulated products (pharmaceutical or agricultural chemical products).

WTO.<sup>11</sup> WIPO may also be a convenient venue to consider this matter initially, as there is no dispute settlement attached to it.

## 2.6. Measurement of Trade and Innovation

A sixth and final area of policy recommendation relates to the importance of improved measurement of trade-related aspects of innovation. While efforts such as the Global Innovation Index (Table 2) have made a good first attempt to link innovation to trade indicators (INSEAD et al. 2013), more work needs to be done. Efforts towards a better measurement of trade-related aspects of innovation are challenged by the fragmentation of institutions (fora), approaches, classifications, taxonomies, and ultimately, databases (Benavente 2014).

**Table 2: Trade-Related Indicators in the Global Innovation Index 2013**

<b>3 Infrastructure</b>	<b>6 Knowledge &amp; technology outputs</b>
3.2.3 Logistics performance	6.1.1 Domestic resident patent ap/bn PPP\$ GDP
3.3.3 ISO 14001 environmental certificates/bn PPP\$ GDP	6.1.2 PCT resident patent ap/bn PPP\$ GDP
4 Market sophistication	6.1.3 Domestic res utility model ap/bn PPP\$ GDP
4.2.1 Ease of protecting investors	6.2.4 ISO 9001 quality certificates/bn PPP\$ GDP
4.3.1 Applied tariff rate, weighted mean, %	6.3.1 Royalty & license fees receipts, % service exports
4.3.2 Non-agricultural mkt access weighted tariff, %	6.3.2 High-tech exports less re-exports, %
4.3.3 Intensity of local competition	6.3.3 Comm. computer & info. services exports, %
<b>5 Business sophistication</b>	6.3.4 FDI net outflows, % GDP
5.2.5 Patent families 3+ offices/bn PPP\$ GDP	<b>7 Creative outputs</b>
5.3.1 Royalty & license fees payments, % service imports	7.1.1 Domestic res trademark reg/bn PPP\$ GDP
5.3.2 High-tech imports less re-imports, %	7.1.2 Madrid trademark registrations/bn PPP\$ GDP
5.3.3 Comm., computer & info. services imports, %	7.2.1 Audio-visual & related services exports, %
5.3.4 FDI net inflows, % GDP	7.2.5 Creative goods exports, %

Source: Benavente 2014

A relatively recent area in which much progress has been made is that of trade in value-added and global value chains (GVCs), or, more generally, the so-called “globalization indicators” (OECD 2010). These novel indicators are crucial for an assessment of innovation capabilities and results. Encouraging the private sector to share its large stock of data with the WTO and similar organizations could advance these efforts towards improved measurement of trade-related aspects of innovation. Confidentiality is always a factor to be acknowledged and respected. However, international organizations such as the WTO and WIPO could encourage national governments to develop surveys in collaboration with the private sector in order to provide useful information concerning all aspects of innovation and trade.

**Policy Option 10:** Medium-term: Enhance efforts towards improved measurement of trade-related aspects of innovation with a view to better inform the negotiating process in the WTO (and other relevant international organizations) so as to make the multilateral trading system more conducive to the development of innovation capabilities and results.<sup>12</sup>

<sup>11</sup> According to Lippoldt and Schultz, such an understanding could be based on a number of principles including: (i) the definition of trade secrets should, in its broad outlines, be no more restrictive than the three-part definition set forth in TRIPS Article 39, paragraph 2; (ii) trade secret law should effectively sanction both breach of duty and third-party misappropriation; (iii) trade secret law should offer a full array of remedies, including ex parte preliminary injunctions; (iv) trade secret laws should include effective provisions for investigating claims; (v) trade secrets should be effectively protected during litigation; and (vi) trade secret laws and related laws should take a balanced approach to employee mobility in attempting to protect confidential information.

<sup>12</sup> This could entail: promote the adoption of the latest classifications; increase cooperation for the collection of data; collaborate between agencies to ensure correspondence between datasets and policy coherence; establish consensual taxonomies in innovation-related sectors; and, improve data packaging and dissemination efforts.

# 3. Way Forward: A Consensus Building Agenda

The central objective of the trade-related policy reform options put forward in this paper is to ensure that existing trade rules and those under negotiation or consideration encourage innovative activity worldwide, not least in support of Sustainable Development Goals. To the extent that new or expanded bilateral, plurilateral or multilateral governance arrangements can be agreed and implemented to ensure that knowledge is accessed internationally as freely as possible, economies around the world would benefit. R&D investments and creative activity are not curtailed by national borders in the sense that innovations that arise therefrom can be accessed and used by those that have sufficient absorptive capacity. In this process, fewer blockages arising from trade rules, regulations and practices, and more creative provisions to overcome these blockages, will speed up the transmission and adaptation of innovation.

The expert group in its deliberations and exploratory work examined a number of issues, some of them more mature for policy consideration than others. The table presented in Annex 1 summarizes the policy options presented in this paper. In conclusion, we offer an overview of different approaches to system reform as well as areas for future research and consensus building.

## 3.1. Approaches to System Reform

While there was no consensus in the expert group on the preferred route for promoting innovation in the context of the existing international trade system, Table 3 provides an illustration of four possible ways to proceed and how some of the policy options might fit into these alternative approaches.

**Table 3: Different Approaches to Innovation and Trade System Reform**

	<b>Incremental approach</b>	<b>More ambitious approach</b>
<b>Within the WTO</b>	<p>For example:</p> <ul style="list-style-type: none"> <li>– Better commitments on Mode 4 in GATS;</li> <li>– Implementation of ITA II;</li> <li>– Clarifying the role of permissible subsidies (e.g. R&amp;D) in the ASCM;</li> <li>– Improving upon TBTs and standards to facilitate innovative procedures.</li> </ul>	<p>For example:</p> <ul style="list-style-type: none"> <li>– Negotiating a Digital Economy agreement as part of the post-Doha agenda;</li> <li>– Developing a non-binding understanding on trade secrets that might eventually be employed as a starting point for a plurilateral accord under the WTO;</li> <li>– Revisiting the TRIPS Agreement or revising some of its provisions.*</li> </ul>
		<p>* This is included in the table solely for indicative purposes, as the Expert Group did not formally consider it a policy option.</p>
<b>Beyond the WTO</b>	<p>For example:</p> <ul style="list-style-type: none"> <li>– Further analyses of deep integration efforts in the context of existing preferential trade agreements (EU, TPP, TTIP, RCEP, etc.) with a view to identifying good practices and eventually multilateralizing them in the WTO in the long term;</li> <li>– Enhance efforts towards improved measurement of trade-related aspects of innovation.</li> </ul>	<p>For example:</p> <ul style="list-style-type: none"> <li>– Establish a plurilateral “innovation zone” working through GATS within which skilled researchers and technical personnel would be able to migrate freely for up to ten years;</li> <li>– To pursue negotiations in other fora to pave the way for future multilateral solutions (e.g. with respect to policy option 6 on the establishment of an Agreement on Access to Basic Science and Technology).</li> </ul>

In view of the current deadlock in the Doha negotiations at the WTO, it can be argued that an incremental approach is the most viable option at the multilateral level (any attempt to revise the TRIPS Agreement in the current environment, for example, would undoubtedly be met with staunch resistance). However, there is a growing tension between what the multilateral trade system can contribute, particularly in terms of timely decisions, and what is required to facilitate innovation on a global scale. In some cases, this tension is also manifest in regional agreements, such as the Trans-Pacific Partnership, where there is disagreement even among industrialized nations for example regarding rules on the optimal level of protection for intellectual property rights. These tensions are likely to continue, to which should be added potential frictions over the implementation of new industrial policies and the provision of public goods to effectively address sustainable development challenges in advanced, emerging and developing countries.

### 3.2. Research Agenda

The cross-cutting nature of innovation and its multifaceted character prevailed and permeated the discussions of the group. Important efforts were made in identifying research gaps and issues that deserve further analysis and reflection at the intersection between innovation, trade and Sustainable Development Goals. As illustrated in this report, even when specific policy options were identified, the options were considered with caution. There was an emphasis on establishing better understanding of the underlying issues as well as the need to carry out further work on a number of the questions examined by the group, including ideas of a more aspirational nature that drew the attention of the experts. A number of queries revolved around the trade-intellectual property-innovation nexus.

Without presuming to be exhaustive, the issues that deserve further consideration include the following. They are listed in four broad thematic areas.

#### 3.2.1. Policy frameworks, innovation systems and best practices

- Examination of best practices within various policy frameworks that encourage innovation-led growth, particularly those that combine strong institutional and legal environments and market driven approaches.
- The role of public procurement in promoting innovation capacity within and amongst countries and sectors.
- Case studies on appropriate links between trade, innovation and competition policies, particularly what role can competition play in promoting innovation?
- Establishment of an information bank to help link research teams across borders with special attention being paid to the incorporation of scientists and researchers from low-income countries.
- Open collaboration schemes and their impact on innovation/learning and networking.
- The role of private-public partnerships in the encouragement of innovation particularly in the achievement of Sustainable Development Goals.
- The impact of natural resources-led growth trade and opportunities on technological learning, particularly in least developed countries (LDCs), and how to diminish negative causalities.

#### 3.2.2. International trading system and plurilateral processes

- Analysis of the extent of subsidies or procurement disciplines on research grants (i.e. the relationship between public research grants and permissible subsidies under the ASCM).
- Need for case studies on how international trade impacts upon innovation differentially –opportunities and challenges—in all countries, particularly LDCs.
- How can sound trade and innovation policies help address the technological divide?
- What are the positive or adverse implications of the current plurilateral and mega-regional norm-setting initiatives to stimulate and improve innovation policy frameworks?

#### 3.2.3. Particular attention to small and medium-sized enterprises (SMEs)

- How can micro innovators and SMEs, as important contributors to the economy, equally benefit from global innovation networks and global value chains?
- In what ways can national innovation systems help SMEs capture opportunities for learning in their integration to GINs/GVCs?
- What are the learning opportunities for SMEs in GINS from existing case studies, and what policy options can be considered to promote them more widely, especially in LDCs?

#### 3.2.4 Intellectual property-related questions

- Case studies on the links between increased protection and enforcement of intellectual property and innovation.
- Best practices in intellectual property policies including the role of exceptions and limitations and their contribution to innovation and technology transfer.
- The influence of patent protection on knowledge sharing and partnerships in general.
- The incidence of other intellectual property categories such as copyright, trademark, trade secrets, designs, as stimulus to innovation.
- Further examination around the implications of trade secrets harmonization in the innovation process.

### 3.3. Consensus Building

There are well established institutions, including those that have partnered together to bring the E15 Initiative to fruition, that could play a role in leading this consensus and bridge building process around the policy options outlined in this paper as well as carrying forward discussion of the issues and research agenda identified above. These processes involve multi-stakeholders working towards finding consensus at the national, regional and international level.

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## Think Pieces

### E15 Expert Group on Trade and Innovation

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The papers commissioned for the E15 Expert Group on Trade and Innovation can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Digital Trade</b>					
<b>1. Include the digital dimension in trade agreements</b>	Medium Term	Digital trade related rules being developed in bilateral and regional trade agreements	Can be just best endeavours provisions	Like minded countries to agree to elevate matters to multilateral level	Member States WTO
<b>2. Establish a Digital Economy Trade Agreement</b>	Long Term	Multilateral trade rules lagging behind in terms of tackling digital trade	Lack of a comprehensive approach to privacy, cross border data, consumer protection, and security matters in existing multilateral trade rules	Consensus building to launch negotiations on a Digital Economy Trade Agreement either as a stand-alone agreement or under the WTO. It could be initiated on a plurilateral basis	Member States WTO
<b>Movement of People: Innovation Networks</b>					
<b>3. Expand Mode 4 GATS commitments</b>	Medium Term	Limited commitments under GATS Mode 4	Lack of convergence/coherence between trade, migration, and labour policies	Expand Mode 4 GATS commitments to encourage mobility of high skilled persons	Member states WTO
<b>4. Establish an “innovation zone”</b>	Long Term	Movement of entrepreneurially skilled persons and research professionals across borders to pursue innovation faces multiple barriers	Lack of mutual recognition regimes relating to the certification of skills acquired in different professions and in different countries	Consensus building among like-minded countries to establish an “innovation zone” through plurilateral agreements in which countries would agree to allow longer-term work visas that would be valid in all participating countries.	Member States WTO

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>Subsidies and Public Grants</b>					
<b>5. Clarify the role of permissible R&amp;D subsidies in the ASCM</b>	Medium Term	The area of disciplines on R&D subsidization is unsettled within the WTO	Subsidies to address global public policy issues are potentially actionable Public grants could become more of an issue of contention	Consensus building to explicitly permit subsidies to address agreed and targeted global public policy issues such as, for example, the development of essential medicines, food security, energy conservation, and climate change	Member States WTO
<b>6. Establish an Agreement on Access to Basic Science and Technology (ABST)</b>	Long Term	Growing demands to enhance the global commons in science and technology in areas of global concern, such as climate change and medicines, without unduly restricting private rights in commercial technologies	Trend towards strengthening of global intellectual property rights regime without a concurrent move to enhance access to and diffusion of science and technology	Hold exploratory discussions on objectives, design, and feasibility of an ABST	Member States WTO
<b>Technical Barriers to Trade and Standardization</b>					
<b>7. Update WTO concepts and definitions on standards</b>	Medium Term	Narrow approach to the concept of standards in the WTO as reflected in the TBT Agreement	WTO concepts of standards were established in a pre-globalization and pre-digital era	Launch process to update WTO concepts and definitions of standards so as to reflect the existence of globally open, transparent, and bottom-up standards to promote global public goods	Member States WTO

Policy Option	Timescale	Current Status	Gap	Steps	Parties involved
<b>8. Reform WTO technical standards processes</b>	Long Term	Lack of inclusivity and openness in current WTO concept of national / intergovernmental standardization	Concept of nation-centric intergovernmental standardization process may ignore key contributors or inhibit their participation	Consensus building towards reform of WTO technical standards processes so as to integrate associated contributions and standards from recognized and well established communities of experts	Member States WTO
<b>Trade Secrets</b>					
<b>9. Bring consistency to the treatment of trade secrets in international trade legal frameworks</b>	Long Term	Growing importance of trade secrets for innovation, especially for small and medium-sized businesses	Wide diversity in national approaches, laws and regulations for the protection of trade secrets	Bring consistency through consensus building towards developing a non-binding understanding or a stand-alone arrangement for consideration in the context of a regional agreement or a plurilateral initiative in the WTO. WIPO may also be a convenient venue.	Member States WTO WIPO
<b>Measurement of Trade and Innovation</b>					
<b>10. Improve the measurement of trade-related aspects of innovation</b>	Medium Term	Growing awareness about the importance of improved measurement of trade-related aspects of innovation to better inform trade negotiations and make them more conducive to the development of innovation capabilities	Fragmentation of institutions (fora), approaches, classifications, taxonomies, and databases	Push forward a series of practical measures such as the adoption of the latest classifications, increase cooperation for the collection of data, collaborate between agencies to ensure correspondence between datasets and policy coherence, establish consensual taxonomies in innovation-related sectors, and improve data packaging and dissemination efforts.	Member States WTO UNESCO WIPO UNCTAD OECD Private sector

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# The Evolving International Investment Law and Policy Regime: Ways Forward

Policy Options Paper



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# The Evolving International Investment Law and Policy Regime: Ways Forward

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on behalf of the E15 Task Force on Investment Policy

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Task Force on Investment Policy. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members and external contributors. Karl P. Sauvant was the author of the report. This paper reflects the author's views as Theme Leader of the E15 Task Force based on the discussions in that Task Force and his own overview paper. The discussions were wide-ranging and intense, but always constructive. Since this report was prepared under the responsibility of the Theme Leader, it does not reflect a consensus view among Task Force members; in fact, views within the Task Force on a number of issues discussed below varied widely. The views of those Task Force members invited to prepare policy papers are contained in the collection of think pieces. The list of group members and E15 papers are referenced. The text was finalized in August 2015.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

### E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15Initiative:  
[www.e15initiative.org](http://www.e15initiative.org)

# Abstract

International investment needs are tremendous. This requires that the international investment regime constitutes a framework for increased flows of sustainable foreign direct investment for sustainable development. The international investment regime covers what has become the single most important form of international economic transactions and the most powerful vector of integration among economies: foreign direct investment and non-equity forms of control by multinational enterprises over foreign production facilities. Among the most striking features of the global investment landscape over the past decade has been the rise of developing economies as outward investors. Yet despite the economic importance of international investment, there is no overarching set of rules governing this subject matter. Instead, the regime consists of over 3,000 international investment agreements, the great majority of them bilateral investment treaties. The present paper examines the state of the international investment law and policy regime and how its governance might be enhanced. Following a thorough analysis of the background to rule-making in international investment, the paper puts forward a set of policy options with the overall objective of increasing

sustainable investment flows, particularly to developing and least developed countries, within the framework of a widely accepted international investment law and policy regime. The interrelated policy recommendations fall under five main categories: expanding the purpose and updating the substantive and procedural provisions of international investment agreements; developing an international support programme for sustainable investment facilitation; addressing the challenge of managing and resolving disputes, especially by further institutionalizing the investor-state dispute-mechanism which lies at the heart of the regime; complementing this effort by establishing an Advisory Centre on International Investment Law; and initiating a process towards the negotiation of a comprehensive international framework on investment that would establish basic rules of engagement among principal stakeholders. The paper ends with a recommendation on procedural issues, namely the launch of an informal and inclusive consensus-building process to accompany and help efforts geared at reforming the international investment regime for increased flows of sustainable foreign direct investment.

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Abbreviations	
BIT	bilateral investment treaty
FDI	foreign direct investment
FTA	free trade agreement
G20	Group of Twenty major economies
GATS	General Agreement on Trade in Services
GVC	global value chain
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
IPA	investment promotion agency
ISDS	investor-state dispute-settlement
M&A	merger and acquisition
MFI	multilateral framework on investment
MFN	most favoured nation
MNE	multinational enterprise
OECD	Organisation for Economic Co-operation and Development
OHCHR	Office of the High Commissioner for Human Rights
PFI	plurilateral framework on investment
TFA	Trade Facilitation Agreement
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TRIMs	Trade-Related Investment Measures
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
UNEP	United Nations Environment Programme
UNGA	United Nations General Assembly
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organization

# Executive Summary

International investment needs are tremendous. All countries seek to attract investment because it involves resources that are central to creating employment, advancing growth and development and ultimately increasing prosperity for all. The public purse will have to finance a considerable share of these needs. But a substantial share will have to be mobilized by the private sector, including international investors. Moreover, not only more investment is needed, but it has to be sustainable investment.

International investment has already become the single most important form of international economic transactions and the most powerful vector of integration among economies. It has become more important than trade in delivering goods and services to foreign markets, and it interlocks national economies through increasingly integrated production networks and global value chains. The presence and commercial links of multinational enterprises (MNEs) across different international markets has led to a substantial share of international trade taking place within global value chains, thus tightly intertwining investment and trade. Emerging markets are increasingly participating in these developments, as both major recipients of foreign direct investment (FDI) and major outward investors. This new reality makes it all the more important to re-examine the governance of international investment.

As part of the E15 Initiative, ICTSD, in partnership with the World Economic Forum, convened a Task Force on Investment Policy to examine the state of the international investment law and policy regime and how its governance might be enhanced to encourage the flow of sustainable FDI for sustainable development. The regime covers the international investment typically undertaken by MNEs, primarily through FDI and various forms of non-equity modes of control, including management and supplier contracts, as well as portfolio investment. The discussions in the Task Force were future-oriented, looking ahead five to ten years—a daunting challenge in a fast-moving field in which some ideas that would have been cast aside as pipedreams only a few years ago are now on the international policy agenda, such as a world investment court.

The purpose of the Task Force was to identify key policy options to help meet the challenge of enhancing the investment regime. Since this report was prepared under the responsibility of the Theme Leader, it needs to be emphasized that it does not reflect a consensus view among Task Force members; in fact, views within the Task Force on a number of issues discussed below varied widely.

In reforming the investment regime, priority needs to be given to special efforts to promote substantially higher flows of sustainable FDI for sustainable development, particularly to developing and least developed countries, within an encouraging and generally accepted international investment framework. The policy recommendations as regards an enhanced investment regime focus on the need to expand the regime's purpose beyond the protection of international investment and the facilitation of efficient investor operations to encompass also the promotion of sustainable development (and allow for the pursuit of other legitimate public policy objectives) and further to institutionalize the regime's dispute-settlement mechanism, complemented by an Advisory Centre on International Investment Law. Negotiations of a multilateral/plurilateral investment agreement could provide an overall framework for international investment, preceded (or accompanied) by an informal consensus-building process.

## The International Investment Regime

***International investment needs require that the international investment regime constitutes a framework for increased flows of sustainable FDI for sustainable development.***

Despite the economic importance of international investment, there is no overarching set of rules governing this subject matter. Instead, the international investment regime consists of over 3,000 international investment agreements (IIAs), the great majority of them bilateral investment treaties (BITs). The investment regime, in turn, increasingly provides the legal yardstick for national rule-making on investment. The international and national investment frameworks together regulate what international investors and governments can and cannot do.

Having the right international investment framework in place is not an objective in itself. In the face of prospects that the world economy may face a decade or more of slow growth, it is unfortunate that world FDI inflows declined substantially from their peak of US\$2 trillion in 2007 as a result of the financial crisis. Flows need not only to recover, but surpass this earlier record. There is no economic reason why FDI flows could not be double or triple what they were in 2007, although the issue is not only more FDI, but more FDI that helps to put the world on a sustainable development path.

Mobilizing such investment requires, first of all, that the economic, regulatory and investment-promotion determinants in individual countries are in place. But the international framework dealing with the relations

of governments and international investors needs to be enabling as well: the framework needs to provide clear rules of the road and a suitable mechanism for resolving disputes between these two actors, should disputes arise. Moreover, the framework needs to provide international support to help all economies that are not members of the Organisation for Economic Co-operation and Development (OECD)—be they developing countries or economies in transition—become more attractive for international investors. An improved investment regime, with enhanced legitimacy, provides the enabling framework for increased flows of sustainable FDI for sustainable development.

The present report focuses on a limited number of topics that have *systemic* implications, with a view towards suggesting ways of enhancing the international investment regime. These topics are discussed separately for analytical reasons, but they are closely interrelated.

## Policy Options and Recommendations

### Updating the purpose of the regime...

Any discussion of strengthening the international investment regime needs to begin with the very purpose of the regime. Given the origin of IIAs, it is not surprising that its principal purpose has been, and remains, to protect foreign investors and, more recently, to facilitate the operations of investors, seeking to encourage in this manner additional FDI flows and the benefits associated with them.

But this purpose alone is no longer sufficient—it needs to be expanded. In particular, IIAs need to recognize, in addition, the need to promote sustainable development and FDI flows that support this objective. Further objectives include the protection of public welfare and human rights, including public health, labour standards, safety, and the environment. Especially more vulnerable economies may require dedicated international support, including through IIAs, in pursuing some of these objectives, a situation further accentuated by the international competition for investment.

Promoting such an expanded purpose of the regime, in turn, necessitates that governments preserve a certain amount of policy space that gives them the right to regulate in the interest of legitimate public policy objectives, a right that needs to be acknowledged in a dedicated provision in IIAs. It also means that investors commit themselves to responsible business conduct. In turn, the contents of IIAs needs to reflect this broadened purpose.

### **...needs to be accompanied by a clarification of key concepts, interrelationships and investor responsibilities...**

“Policy space” is a vague and sometimes politicized concept. Care needs to be taken that it is not interpreted as a *carte blanche* for governments to disregard international commitments such as non-discrimination.

This is similar to the challenge of ensuring that other key concepts and protections contained in IIAs are not interpreted too broadly. If IIAs contain language that refers to general principles and rules that leave excessive scope

for interpretation, it may become difficult for international investors to know what treatment they can expect from host country governments, and for host country governments to know what they can or cannot do vis-à-vis international investors. Uncertainty, in turn, increases the probability of disputes. Legal certainty should be maximized.

Accordingly, an important aspect of enhancing the investment regime concerns clarifying the key concepts in IIAs, by providing tighter wording that defines as clearly as possible the sort of injuries for—and circumstances in—which investors can seek compensation, and the type of actions governments can and can not take. The development and generalized use of standardized wording would help in this regard. Clarifications are also needed concerning the interrelationships of the international investment regime with other substantive areas of international law, especially those pertaining to human rights, the environment, labour, and trade, as well as taxation and incentives.

Progress has been made on the above, but more needs to be done. This includes the difficult challenge of defining sustainability characteristics of international (and domestic) investments. A working group should be established to prepare, in a multi-stakeholder process, an indicative list of FDI sustainability characteristics that could be utilized by interested governments seeking to attract sustainable FDI.

There is also the question of the responsibilities of investors, to promote desirable corporate conduct and discourage undesirable behaviour. Host country governments, as sovereigns, can of course impose obligations on investors in their national laws and regulations, and have done so. Investors have to abide by them, making them liable for any infringements that might occur. Beyond that, various non-binding/mixed instruments designed, *inter alia*, by the OECD, the International Labour Organization (ILO) and the Office of the High Commissioner on Human Rights (OHCHR) address this issue, and these should be developed further.

But there is the question of the extent to which IIAs limit the ability of host countries to impose obligations on investors, or discourage them from doing so, for fear of transgressing on treaty provisions. The introduction of investor responsibilities in IIAs could remedy this situation by providing international standards, although it would not be easy to obtain broad consensus on such standards. Moreover, broad consensual international standards on this matter could also help countries with limited capacity to implement their own laws and regulations in this area, at least to a certain extent.

Expanding the purpose of IIAs, providing greater clarity of key concepts, acknowledging interrelationships with other legal regimes, and recognizing investor responsibilities should all be pursued going forward.

A working group consisting of leading international investment experts, including practitioners, could propose how the purpose and contents of IIAs could best be updated, in close consultation with principal stakeholders. Such a group could benefit from the support of a consortium of leading universities from all continents, as well as other interested stakeholder organizations. The results could be presented to governments, for their consideration in future investment rule-making.

**...and a special effort to encourage the flow of sustainable FDI for sustainable development.**

One particular aspect of the purpose and contents of the international investment regime deserves special attention, namely the efforts of virtually all governments to attract FDI and benefit from it as much as possible. But a number of governments, especially of the least developed countries, have weak capabilities to compete successfully for such investment in the world FDI market. For that reason, an international support programme for sustainable investment facilitation should be launched, focused on improving national FDI regulatory frameworks and strengthening investment promotion capabilities. Such a programme should concentrate on practical ways and means of encouraging the flow of sustainable FDI to developing countries and, in particular, the least developed among them. It should be geared towards strengthening the capacity of investment promotion agencies (IPAs) in developing countries. It would fully complement the various efforts to facilitate trade, notably those governed by the WTO-led Aid for Trade Initiative and the recently adopted WTO Trade Facilitation Agreement, by creating an integrated platform for promoting sustainable FDI.

In fact, one option to implement such a programme would be to extend the Aid for Trade Initiative to cover investment as well, and fully so, into an Aid for Investment and Trade Initiative. Another, medium-term, option would be to expand the Trade Facilitation Agreement to cover sustainable investment, turning it into an Investment and Trade Facilitation Agreement. A third option is for all—or a group of interested—countries to launch a Sustainable Investment Facilitation Understanding that focuses entirely on practical ways to encourage the flow of sustainable FDI to developing countries. Work on such an Understanding could be undertaken, in due course, in the WTO. It could also begin within another international organization with experience in international investment matters, perhaps UNCTAD or the World Bank or the OECD. Or, a group of the leading outward FDI countries could launch such an initiative. The impetus could come from the G20, which could mandate the initiation of such work.

The proposal's key premise is the importance—and urgency—of creating more favourable national conditions for higher sustainable FDI flows to meet the investment needs of the future. As governments and the private sector increasingly share this view, they need to muster the political will to put an international support programme for sustainable investment facilitation in place.

**Any disputes need to be resolved through a dispute-settlement mechanism that is beyond reproach, ...**

Even if the investment regime's purpose is enhanced and its contents are clarified, disputes between international investors and host country entities can arise. Governments therefore need to develop national investor-state conflict management mechanisms that allow governments and investors to address their grievances well before they escalate into full-blown legal disputes.

But it is unavoidable that some disputes reach the international arbitral level. It may be possible to deal with some of them through alternative dispute-settlement

mechanisms, and the use of such mechanisms needs to be encouraged further. But given the centrality of the investor-state dispute-settlement (ISDS) mechanism to the investment regime, that mechanism has to be beyond reproach. This is not only a technical matter, but also one that has implications for the very legitimacy of the international investment regime. A number of steps have already been taken to improve this mechanism, but more needs to be done.

The principal major reform would involve the establishment of appeals mechanisms for the current *ad hoc* tribunals or (as recently proposed by the European Commission) a world investment court as a standing tribunal making the decision in any dispute-settlement case, or a combination of both. Further institutionalizing dispute settlement in this manner could be a major step towards enhancing the investment regime, comparable to the move from the *ad hoc* dispute-settlement process under the GATT to the much-strengthened Dispute Settlement Understanding of the WTO. Institutional development in this direction could not ensure the full consistency of the application of IIAs, given that the underlying treaties are not uniform, even though these agreements share certain principles and recurrent core concepts. However, it could, over time, enhance consistency, help make the dispute-settlement process more accountable and develop a body of legally authoritative general principles and interpretations that would increase the coherence, predictability and, ultimately, the legitimacy of the investment regime.

Several arrangements are conceivable. For example, awards issued by the *ad hoc* panels currently used in IIA disputes could be appealed to *ad hoc* appellate bodies. Or one could envisage the establishment of a single permanent and independent world investment court. Or one could imagine an appellate mechanism for reviewing awards being established in the framework of a treaty between two or more parties, to review decisions of *ad hoc* tribunals; other states would be invited to opt in to make use of that mechanism as well, multilateralizing the appellate mechanism in this manner. Finally, since the International Centre for Settlement of Investment Disputes (ICSID) is the single most prominent dispute-settlement venue, one could think of a treaty updating the present Convention on the Settlement of Investment Disputes between States and Nationals of Other States—an ICSID II, so to speak. Such a new treaty could create a single world investment court (and appellate body) that would be available to all governments that have signed and ratified such a treaty.

Finally, there is the question of access to any dispute-settlement mechanism. In particular, if the contents of IIAs are expanded to include investor responsibilities, governments arguably should have direct access to the regime's dispute-settlement mechanism. The question would also arise—and this would be a profound and very ambitious change—whether the dispute-settlement process should then be opened up to other stakeholders too.

Steps in this direction would profoundly change the nature of the international investment dispute-settlement process by turning it from an *investor-state dispute-settlement mechanism* into an *investment dispute-settlement mechanism*. This, in turn, could dramatically modify the dynamics of the current international ISDS discussion.

However challenging the task of improving the current dispute-settlement mechanism may be in terms of overcoming numerous political and technical difficulties, embarking on the process of exploring how this could be done with a view towards developing a better mechanism would send a strong signal that governments recognize that this mechanism requires improvement. This is not merely a technical question but (as the public discussions of ISDS show) a matter of what is considered fair by public opinion.

Discussions of the range of issues relating to this matter are already underway in a number of governmental and non-governmental forums, ranging from the European Parliament to various academic conferences. These should be expedited. All interested stakeholders should be heard and all pertinent issues should be addressed.

**... which would be helped by the creation of an Advisory Centre on International Investment Law.**

A similar, and strong, signal demonstrating the will to enhance the legitimacy of the dispute-settlement process would be sent if the ability of vulnerable economies to defend themselves as respondents in investment disputes would be improved. Conversely, a dispute-settlement mechanism that does not provide a level playing field for the disputing parties can easily be seen as compromised, undermining its very legitimacy. Access to justice must not only be seen as fair, it has to be fair in its very *modus operandi*.

Least developed countries particularly do not generally have the human resources to defend themselves adequately. And many simply do not have the financial resources to hire the required expertise, which also does not help the efficiency and quality of the arbitration process. This puts many countries in an asymmetric situation whenever a dispute arises.

An independent Advisory Centre on International Investment Law would help to establish a level playing field by providing administrative and legal assistance to respondents that face investor claims and are themselves not in a position to defend themselves adequately. While a number of issues would have to be considered before establishing such facility, the experience of the Advisory Centre on WTO Law shows that it can be done—to the benefit of the world trading system.

Similar considerations apply to small and medium-size enterprises, as these too typically do not have the expertise and resources to bring claims. They too require support. Costs and delays could become even more of an obstacle if an appeals mechanism were to be established. A small-claims settlement mechanism, with an expedited process, set deadlines and sole arbitrators, could be of help in this regard.

Independently of these two institutions (the Centre and the small-claims mechanism), and as a low-cost alternative dispute-settlement mechanism of potential value to both governments and (in particular small) firms, an International Investment Ombudsperson could be designated, cooperating with an *ad hoc* ombudsperson in a respondent state.

The process of clarifying the issues surrounding the creation of an Advisory Centre on International Investment Law should begin now, with a view towards bringing it into being in a short period of time. It would be very desirable if a few governments particularly concerned about the legitimacy of the international investment regime would assume a lead role in establishing such a Centre and small-claims settlement mechanism. They could be supported by a non-governmental organization with a track record of work on the international trading system, and they could seek to draw on the experience of intergovernmental organizations with an interest in this subject.

***A comprehensive international framework on investment would establish basic rules for the relations between principal stakeholders,***

The discussion so far has focused on individual—but key—aspects of the international investment regime and how they could be improved. But one could also take a holistic approach to the governance of international investment, namely to negotiate a comprehensive universal framework on international investment, preferably a multilateral framework on investment (MFI), possibly starting with a plurilateral framework on investment (PFI) that would be open for future accessions by other states. Such a framework would have to start from the need to promote sustainable FDI for sustainable development. The convergence of policy interests that has been underway between home and host countries with the growth of outward FDI from emerging markets could facilitate reaching such an objective.

Moreover, it is significant that governments continue to show a great willingness to make rules on international investment, as revealed in the proliferation of IIAs. This is particularly reflected in the negotiation of BITs between key countries, as well as in the negotiation of mega-regional agreements with investment chapters. Together, these negotiations represent significant opportunities to shape the investment regime by narrowing the substantive and procedural investment law differences between and among the principal FDI host and home countries. If this should occur, the result of these negotiations could become important stepping stones towards a subsequent universal investment instrument. Still, the negotiation of such an instrument, especially a high-standards one, would face significant challenges, in light of the unsuccessful efforts of the past and the wide range of views and the considerable passion surrounding IIAs.

Given these and other challenges, it would be desirable to begin a process of exploring the possibility of negotiating an international framework on investment, ideally of a multilateral nature. This may be particularly pertinent in light of the July 2015 decision by the Third International Conference on Financing for Development to mandate UNCTAD to work with member states to improve IIAs, and the experience of that organization in this area, not least in its comprehensive recent effort to facilitate the formulation of a new generation of investment policies through its Investment Policy Framework for Sustainable Development.

On the other hand, the WTO offers the best platform for the trade and investment regimes to be combined and consolidated, as a unified system providing systematic legal and institutional support for the future growth of global value chains, turning that organization into a World Investment and Trade Organization. If this course were to be pursued, the WTO's Working Group on the Relationship between Trade and Investment could be reactivated in due course, or a new working group could be established. Another alternative is to build on existing agreements, especially the WTO's General Agreement on Trade in Services, to cover other types of investment and obligations. There might also be the possibility that the international investment court and appellate mechanism sought by the European Commission could become a stepping stone towards a permanent multilateral system for investment disputes, which, in turn, could become the nucleus around which a universal framework could be built.

If a truly universal and comprehensive strong investment framework is out of reach at this time, a plurilateral framework on international investment could serve as a first step in that direction. Following the example of the Trade in Services Agreement, it could be an agreement negotiated by interested parties that would be open for future accessions by other states. The situation may be favourable for such an initiative, in particular if the China-United States BIT should be concluded expeditiously. If that should occur, the most important home and host countries among developed and developing countries would have negotiated an agreement that could serve as a template that could be taken forward. The 2016 G20 summit in China could initiate such a process.

## Next Steps: An Informal and Inclusive Consensus-Building Process

***This effort towards building a comprehensive international framework on investment should be accompanied and helped by an informal consensus-building process.***

As the public debate about the investment regime and the debate within the international investment law community suggest, improving the regime has become a matter of urgency. Improvements in the regime should be sought subject area by subject area, when negotiating individual IIAs. Where new initiatives need to be taken, they should be launched as soon as possible. Finally, preparations for the negotiation of a multilateral/plurilateral investment agreement should be seriously considered. In the end, any systematic process to improve the investment regime needs to be government-led and -owned.

However, considering the range of stakeholders involved in international investment matters, it would be advisable to launch an (accompanying) informal but inclusive confidence-, consensus- and bridge-building process on how the international investment law and policy regime can best be enhanced. Such an informal process should take place outside an intergovernmental setting, to stimulate and encourage a free and open discussion of all the issues involved. It should be a process organized by a trusted institution, perhaps with the support of a few individual countries particularly interested in this subject. It should take a holistic view of what needs to be done, drawing on the important work carried out in recent years by established international organizations. It should identify systematically any weaknesses of the current regime and advance concrete proposals on how to deal with them— not only regarding the relationship between governments and investors, but also with a view towards increasing sustainable FDI flows and the benefits of these flows. It would have to be an inclusive process that involved the principal stakeholders to ensure that all issues are put on the table and all key interests are taken into account.

The outcome of such a process could be a draft agreement that could be made available to governments to use as they see fit. In any event, the outcome should be made available widely, to help governments improve the international investment law and policy regime as the enabling framework for increased flows of sustainable FDI for sustainable development.

# 1. Introduction

As part of the E15 process, a Task Force on Investment Policy composed of leading experts examined the state of the international investment law and policy regime and how it might be enhanced to encourage the flow of sustainable foreign direct investment (FDI) for sustainable development. The regime covers the international investment typically undertaken by multinational enterprises (MNEs—firms that control assets abroad for the purpose of making a profit), primarily through FDI and various forms of non-equity modes of control, including management and supplier contracts, as well as portfolio investment.<sup>1</sup> International investment involves resources—the tangible and intangible assets embodied in investment—that are central to the creation of employment and, more generally, the promotion of economic growth and development.<sup>2</sup> All countries seek to attract these resources.

The Task Force met at a time when issues relating to the international investment regime had been receiving attention far beyond the confines of the group of investment *cognoscenti* within which they have traditionally been discussed, namely a small group of investment negotiators, practitioners, legal counsels of firms, and academics, with the sporadic involvement of non-governmental organizations. To illustrate, public consultations by the European Commission in the context of the Transatlantic Trade and Investment Partnership (TTIP) yielded a great number of replies on investment protection and investor-state dispute-settlement (ISDS), the mechanism at the heart of the investment regime (European Commission 2015b). Newspapers and leading opinion makers dedicated articles to ISDS in mass media outlets, alerting public opinion to issues few outside the small group of investment experts had heard about until then. No less than the President of the United States, Barack Obama, explained in considerable detail what ISDS was all about in a conference call with reporters (Sargent 2015). And the President of Ecuador, Rafael Correa, critically addressed the issue in his 2014 Prebisch Lecture (Correa 2014).

Such growing policy attention is justified. As will be documented briefly below, the international investment regime covers what has become the single most important form of international economic transactions and the most powerful vector of integration among economies: FDI and non-equity forms of control by MNEs over foreign production facilities. These have become more important than trade in delivering goods and services to foreign markets, and they interlock national economies through their production networks: the sales of foreign affiliates alone amounted to US\$36 trillion in 2014, compared to world exports that year of US\$23 trillion.<sup>3</sup> The presence and commercial links of MNEs across different international markets has led to a substantial and rising share of international trade taking place within global value chains and as intra-company transactions, thus tightly intertwining investment and trade. Furthermore, developing countries have emerged as both major recipients of FDI and major outward investors, through their own MNEs. As a result, FDI and non-equity forms of control integrate not just national markets through trade but also national production systems through investment.

Yet, despite the economic importance of international investment, there is no overarching and unified set of rules governing this subject matter. Instead, the investment regime consists in the main of over 3,000 international investment agreements (IIAs). The great majority of these agreements are bilateral investment treaties (BITs), but virtually all recent bilateral and regional free trade agreements also feature comprehensive investment chapters. Both types of instruments deal primarily with the treatment of international investors by host countries. These agreements, furthermore, are supplemented by contracts between states and individual investors, as well as a number of voluntary, soft law, instruments that address primarily various aspects relating to international investors, such as corporate social responsibility and anti-competitive conduct.

<sup>1</sup> “Foreign direct investment” is formally defined as “an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate)” (UNCTAD 2015b, 3, Methodological Note). Definitions in international investment agreements are normally broader and include any kind of assets of foreign investors.

<sup>2</sup> For a comprehensive discussion of the role of FDI in development and its various aspects, see UNCTAD’s *World Investment Report* series, various years.

<sup>3</sup> The data reported in this paper are from UNCTAD, *WIR2015*, op. cit., or earlier editions of this publication, unless otherwise indicated. The estimated sales number reported here represents a minimum, as it is based on FDI figures. In other words, it does not include sales of other entities that are under the common governance of the parent firms of MNEs, especially through various non-equity forms.

Having the right international investment framework in place is not an objective in itself. In the face of prospects that the world economy may face a decade or more of slow growth, it is unfortunate that world FDI inflows almost halved from a high of some US\$2 trillion in 2007 to US\$1.2 trillion in 2009 as a result of the financial crisis. Flows need not only to recover, but surpass this earlier record. In 2014, FDI inflows as a percentage of world gross domestic capital formation stood at 6.5%, although it was much higher in a number of developed and developing countries. There is no economic reason why this share could not be double or triple, although the issue is not only more FDI, but more FDI that helps to put the world on a sustainable development path.

The world is awash in capital, and the world's investment needs are tremendous. Mobilizing such investment requires, first of all, that the economic, regulatory and investment-promotion determinants in individual countries are favourable. But the international framework dealing with the relations of governments and international investors needs to be enabling as well: it needs to provide clear rules of the game and a suitable mechanism for resolving disputes between these two main actors, should such disputes arise. And the framework needs to provide international support to help emerging markets become more attractive for international investors.

Given the importance of international investment for economic growth and development, the patchwork nature of the regime governing it and, in particular, the operation of the regime's dispute-settlement mechanism, it is not surprising that public attention focuses on the regime's strengths and weaknesses. In light of this, the E15 Task Force on Investment Policy examined a number of key policy challenges related to the governance of international investment and, in particular, the evolving interaction between international investors and governments, with a view towards identifying policy recommendations. The discussions were future-oriented, looking ahead five to ten years—a daunting challenge in a fast-moving field in which some ideas that would have been cast aside as pipedreams only a few years ago are now on the international policy agenda, such as a world investment court.

In reforming the investment regime, priority needs to be given to special efforts to promote substantially higher flows of sustainable FDI for sustainable development, particularly to developing and least developed countries, within an encouraging and generally accepted international investment framework. The policy recommendations as regards an enhanced investment regime focus on the need to expand the regime's purpose beyond the protection of international investment and the facilitation of efficient investor operations to encompass also the promotion of sustainable development (and allow for the pursuit of other legitimate public policy objectives such as public welfare and human rights) and further to institutionalize the regime's dispute-settlement mechanism, complemented by an Advisory Centre on International Investment Law. Negotiations of a multilateral/plurilateral investment agreement could provide an overall framework for international investment, preceded (or accompanied) by an informal consensus-building process.

# 2. Background to Rule-Making on International Investment

## 2.1 The Rise of International Investment: Needs, Determinants and Growth

The world's investment needs are tremendous: to upgrade the physical infrastructure for the 21st century; to build the science, technology and innovation capacity required to advance the frontier of knowledge; to transition to a low-carbon world economy to halt climate change; to meet the Sustainable Development Goals; and, ultimately, to create employment, advance growth and development, and increase prosperity for all. This will require, annually, trillions of dollars of new investment. To illustrate these needs, consider one of the infrastructure-related Sustainable Development Goals, the financing requirements for water infrastructure in the developed countries, Brazil, Russia, India, and China. Over the next 10-15 years alone, such requirements are estimated at US\$770-1,040 billion per year, with another US\$100 billion needed for all other developing countries, compared to present annual spending of about US\$550 billion (Brabeck-Letmanthe 2015).

The public purse will have to finance a considerable share of these investment needs. Official development assistance will also have a role to play, especially in the case of the least developed countries. New and innovative sources of finance have potential. But a substantial share of future investment needs will have to be financed by the private sector, using a variety of equity and non-equity modes. In the great majority of countries, the domestic private sector will by far have to assume the leading role. But international investors can play an important role as well. They can do so by complementing and catalysing domestic investment by deploying a range of tangible and intangible assets, including finance, technology, skills, and access to markets. Increasing and maximizing the contribution that international investment can make, be it through equity participation, non-equity relationships or the creation of locally grounded global value chains, requires that the investment determinants are right.<sup>4</sup>

Among these determinants (that is, the conditions on the basis of which firms decide where to invest), the economic ones are crucial, as they determine to a large extent the attractiveness of a particular location and the ability of investors (be they domestic or foreign) to be productive and contribute to the growth and development of the economies in which they are located, while also being profitable. Particularly important among these economic

determinants are the size and growth of markets, the quality of the physical and technology infrastructure, and the availability of skilled human resources. While the economic determinants are not everything, everything is nothing if the economic determinants are not favourable. Across the world, considerable progress has been made in recent years in strengthening the economic determinants of investment.

Another important determinant is the FDI regulatory framework, including the institutional/legal infrastructure, which has to be enabling, while allowing host countries to maximize the benefits of FDI. There, too, considerable improvements have been made over the past two decades, though more can be done, benefitting both domestic and foreign investors.

Finally, as the FDI regulatory framework has become comparable across countries, investment promotion assumes increasing importance in influencing the locational choices of investors. Today, virtually every country has an investment promotion agency, and many have such agencies also at the sub-national level. However, their effectiveness in terms of attracting FDI and benefitting from it differs greatly, putting those countries with weak agencies at a disadvantage in the highly competitive world FDI market.

International investors have responded to the improvement of the investment determinants. From an annual average of US\$50 billion during the first half of the 1980s, FDI inflows reached (after having declined in light of the financial crisis) US\$1.2 trillion in 2014, for an aggregate FDI stock of US\$26 trillion. More than 100,000 MNEs control at least one million foreign affiliates. Some 70,000 of these MNEs are headquartered in the member countries of the OECD, while some 30,000 hail from non-OECD economies. Regardless of whether MNEs are rooted in OECD or non-OECD countries, they have invested in virtually all sectors and throughout the world. The services sector alone accounts for nearly two-thirds of the world's investment flows and stock, and natural resources for almost one-tenth. Traditionally, the OECD countries attracted most FDI flows, but now non-OECD economies attract more than half of these flows (US\$729 billion in 2014). Much FDI takes the form of mergers and acquisitions (M&As), regardless of whether parent firms are headquartered in OECD or non-OECD markets. While the biggest MNEs

<sup>4</sup> The focus is here narrowly on FDI determinants. Naturally, the business climate in general, and in particular the quality of institutions in host countries, is of key importance as well, not only for foreign investors but especially also for domestic investors.

control the lion's share of the world's FDI stock, most MNEs are small or medium-size enterprises. These often have limited capabilities to access finance and information about investment opportunities, staff international operations and deal with difficulties in host countries when these arise.

Among the most striking features of the global investment landscape over the past decade has been the rise of non-OECD economies as outward investors. Firms headquartered in these economies accounted for US\$531 billion of world FDI outflows in 2014, some two-fifths of the world total that year. This is more than ten times the world's FDI flows during the first half of the 1980s. Firms headquartered in 138 non-OECD economies on which data were available had an accumulated stock of outward FDI in 2013, and 75 of these economies reported FDI outflows for every year during the period 2009-2013. At the same time, though—and as in the case of the developed countries—a limited number of economies account for the bulk of these outflows. Emerging market MNEs have become important players in the world FDI market, although, if economic conditions deteriorate in their home countries, this role may be affected negatively.

## 2.2. The Emergence of an Integrated International Production System and the Interrelationship Between Investment and Trade

Another salient feature of the past two decades is that MNEs increasingly locate specific activities wherever it is best for them to increase their efficiency as wealth-creators, while of course fostering their profitability. This concerns not only the production of “nuts and bolts,” so to speak, but also increasingly various components of service activities and, indeed, various headquarter functions. The digital revolution is driving this development (Eden 2015). This evolution in corporate strategies and structures involves tight interactions between investment and trade, leads to a deep integration of national economies, and raises a number of policy issues.

Firms are moving towards an international intra-firm division of labour and distribution of functions and competences by building corporate networks of foreign and domestic affiliates that specialize in the production of various parts and components that, eventually, are assembled in any location in the world best suited for this purpose. Moreover, firms that are not tied to particular parent firms through ownership arrangements are becoming part of the production networks of these firms through various non-equity arrangements—which makes such contractual arrangements important assets of international investors. The resulting value chains are often regionally centred, especially in Asia (although they are typically referred to as “global” value chains). Within these networks, “the main value contributed by the MNC is not physical investments, but rather knowledge, organization for an efficient flow of information, trust, etc.” (Oberhänsli 2015, 2). More generally, while parent firms remain the ultimate decision-makers in value chains, the role of headquarters increasingly becomes that of deciding where various production activities should take place, organizing a highly complex network, providing key tangible and intangible assets (for example, finance,

brand names, research and development), orchestrating information and knowledge flows within the network, and ensuring that profits are maximized globally for the enterprise as a whole. The efficiency of these arrangements, part of the emerging digital economy, becomes an important source of wealth-creation that, if policies are right, can benefit host and home countries, including consumers worldwide.

At the same time, the emergence of such complex networks coordinated by headquarters makes it difficult at times to identify the boundaries of a particular firm, assigning origin for purposes of determining eligibility for preferential treatment or to determine liability in case of, for instance, gross negligence. It also means that the distinction between host and home countries is losing its sharpness. This, in turn, has implications, for example, for questions related to taxation, for where to put legal titles for patents and trademarks, and for determining corporate nationality (important, among other things, for the question of standing in international investment disputes and for determining accountability in cases of human rights violations for instance).

But there are also challenges for firms. For example, when an MNE acquires another MNE, the acquisition may have to go through a merger review in a number of countries, each with its own criteria and time frames, potentially seriously delaying an intended acquisition (Gestrin and Novik 2015). Thus, “in the absence of cooperation and consistent enforcement, international investors are faced with heightened uncertainty over their investment plans” (Gestrin and Novik 2015, 6). Greater coordination among competition authorities will become increasingly necessary. More generally, integrated international production systems require “[r]educing government barriers to complex integration;” in other words, a “key focus must be the need to reduce the costs of firms and households engaging in cross-border transactions. As natural market imperfections continue to fall in the digital economy (frictionless, virtual trade), the barriers to trade and FDI flows generated by government policies become more visible and important” (Eden 2015, 13).

The emergence of an integrated international production system defined by global value chains puts to rest the old question of whether FDI leads to trade or trade leads to FDI. Rather, the question becomes: where do firms locate their production facilities, be it for manufacturing or services? If the location is at home, it is domestic investment; if the location is abroad, it is foreign direct investment. As production becomes more dispersed, the locational outcome may involve multiple facilities, and the resulting transactions may comprise domestic sales, sales by affiliates overseas and the intermediate trade of products, parts and components within corporate networks. Foreign direct investment and trade are necessary complements for integrated international production.

The intertwining of investment and trade has policy implications (Hufbauer and Moran 2015). This was recognized in the WTO Agreement (within the Uruguay Round package) on Trade-Related Investment Measures (TRIMs), which addresses restrictive and distorting effects that certain investment measures may have for trade in

goods; additional measures, which may also be targeted at services, are prohibited in other IIAs, especially bilateral investment treaties. On the other hand, a number of “investment-related trade measures” can distort cross-border investment flows. Particularly important here are rules of origin and tariff escalation. Unlike trade-related investment measures, the latter have received little attention in multilateral disciplines.

The integration of trade and investment activities also raises challenging dispute-settlement issues, given that the existing international law regimes for resolving trade and investment disputes are based on different models. International trade disputes are resolved on a state-to-state basis, with no direct right of access to relief for companies, while international investors typically possess such a direct right of access to resolve international investment differences under investor-state dispute-settlement procedures. With increasing frequency, companies are pursuing relief within the investment dispute-settlement system for what could be characterized as trade activities, such as transactions involving the international sale of goods or cross-border services.<sup>5</sup> Pursuing such relief based on the integrated nature of a company’s trade and investment activities can raise difficult issues of standing, for example, when a claim is brought by a company in its capacity as an investor, or, alternatively, in its capacity as an exporter or cross-border services provider. Integrated trade and investment activities can further raise challenging damages issues in investment disputes, for instance, when damages arising from a decrease in the sales of goods or cross-border services are recoverable under investment treaties if they “relate to” an investment in the host country. If left unaddressed, such uncertainties arising from the integration of trade and investment activities could ultimately expose host country governments to greater levels of risk under investment treaties.<sup>6</sup>

### 2.3. Investment Rule-Making in the Context of Various Tensions

As mentioned earlier, FDI flows would have to rise considerably to help meet the world’s investment needs and thus make a substantial contribution to global economic growth and sustainable development. This requires a further enhancement of the economic determinants, as well as of the regulatory framework and investment promotion. Given the focus of the work of the E15 Task Force on Investment Policy, the subsequent discussion will focus on the international regulatory framework for international investment. The international investment law and policy regime increasingly sets the parameters, and provides the legal yardstick, for national policy-making on investment. Trends in national FDI laws and regulations, in turn, are important because they foreshadow the orientation of international investment rules, as governments seek to promote and protect their national policy objectives in this area. Together, the national and international frameworks

regulate what international investors can and cannot do, and they determine, to an important extent, the distribution of benefits between international investors and host countries.

International and national rule-making on international investment takes place against the backdrop of distinct sets of tensions that governments need to reconcile when seeking to attract FDI and benefit from it as much as possible, even if some of these tensions do not necessarily involve objectives that are opposite to each other. Such tensions can include: the global corporate interests of MNEs vs. the national development interests of countries; foreign vs. domestic ownership, especially in sensitive industries; policies to attract FDI vs. policies to maximize the domestic benefits and minimize any negative effects of such investment; a country’s interests as host vs. home country for investment; and, the constraints of the emerging integrated international production system, a globalizing world economy and international investment law vs. the need to preserve policy space in pursuit of legitimate public policy objectives.

To illustrate two of these tensions: MNEs evaluate the benefit of their FDI projects in relation to maximizing their own competitiveness and profitability within the framework of their global corporate networks, while governments seek to maximize the benefits of the same projects within their own territorial boundaries—for them, FDI is but a tool to advance their countries’ economic growth and development. Or, as host countries, governments seek to maintain policy space to pursue their own legitimate public policy objectives, while, as home countries, governments seek to protect the investment of their own firms abroad and facilitate their operations by limiting the policy space of host countries.

The above tensions create dilemmas for policy-makers, who typically need to consider various (often conflicting) objectives in the context of contradictory pressures from various stakeholder interests. Among stakeholders, non-governmental organizations have become vocal and important actors at the national and international levels, and their views need to be taken into account.

These dilemmas and pressures impose limitations on the formulation of national laws and regulations and affect the terms of entering into IIAs (IIAs also include certain WTO agreements, notably the General Agreement on Trade in Services (GATS) and the TRIMs Agreement).<sup>7</sup> In view of the underlying tensions in the relationship between foreign investors and host countries outlined above, the task of policy-makers is to maximize the positive effects of FDI (and, for that matter, investment in general) in their countries and minimize any negative ones. Hence, national policies regarding FDI, and the international regulatory framework within which national policies are formulated, are of key importance for host countries to attract FDI and benefit from it.

<sup>5</sup> For a discussion of several NAFTA cases involving the intersection of trade and investment, see Feldman (2014).

<sup>6</sup> One way to address this issue may be by examining whether a claimant has undertaken a transaction in its capacity as investor. See *ibid.* for a discussion.

<sup>7</sup> Roughly two-thirds of FDI consists of services FDI; the “commercial presence” provisions of the GATS are therefore of immediate relevance for the lion’s share of FDI.

## 2.4. National Rule-Making on International Investment

The national regulatory framework for FDI defines whether and under what conditions foreign investors can enter a host country, operate in it and exit it. It is therefore of central importance to both host countries seeking to attract FDI and benefit from it, and to MNEs seeking to establish a portfolio of locational assets that serves their international competitiveness best. At the same time, the broader national regulatory framework, as well as the business climate in general, is also of key importance to domestic investors: typically, what is good for foreign investors is also good for domestic investors.

Over time, national FDI frameworks have changed considerably, inspired often by policy benchmarking (Oberhänsli 2015). After not being welcoming towards foreign investors during the 1960s, 1970s and early 1980s<sup>8</sup> (a policy stance frequently enforced through national screening agencies), host country policies turned decisively welcoming during the 1990s.<sup>9</sup> During that decade, some 95% of national FDI policy changes that UNCTAD recorded worldwide went in the direction of making the investment climate more hospitable for foreign investors. Governments liberalized economic sectors to FDI, removed caps on investments or raised ownership ceilings for such investment. They generally facilitated the operations of MNEs and their foreign affiliates in host countries by, among other measures, relaxing performance and approval requirements and simplifying business registration procedures. They marketed their countries to investors. They offered incentives to attract FDI, with locational competition unleashing fiscal wars at the sub-national level in some countries. They assisted incoming investors in various ways, including by offering information, coordinating investor visits and providing after-investment services. They liberalized the repatriation of earnings and other capital. And they codified various protections in national regulations, laws or even constitutions. In the 1990s, countries also began to establish investment promotion agencies whose specific aim was (and remains) to attract as much FDI as possible. Red carpet had replaced red tape.

Since the turn of this century, however, national approaches towards incoming FDI have become more nuanced and guarded, primarily in OECD countries. This is so even as the majority of policy changes continue to go in the direction of making the investment climate more welcoming, in particular in non-OECD economies. However, the number of regulatory changes that do the opposite has risen considerably since 2000, reaching between 20-30% of total national investment policy changes during the past

few years,<sup>10</sup> often to correct market failures and address negative externalities, and in line with a broader trend towards regulatory precaution. Many of the latter measures are directed at entry conditions for foreign investors, particularly in natural resources (including agriculture) and the services sector. A number of host country governments also have come to treat some M&As differently from greenfield investments. While the latter are universally welcome (creating, as they do, additional production capacity), M&As are at times regarded with suspicion. This is especially the case when M&As raise competition concerns, take place in politically sensitive industries, are undertaken by state-controlled entities and, in particular, are seen as posing a threat to national security (however defined, and including national economic security). This can be seen in the strengthening of the investment-review mechanisms in such countries as Australia, Canada, China, Germany, and the United States.

The challenge for national FDI policy-makers is to find the right balance among instituting policies to attract FDI and seeking to increase its benefits to their economies, on the one hand, and regulating FDI inflows in pursuit of legitimate national public policy objectives, on the other, without compromising the investment climate and deterring foreign investors. Achieving this balance is made more difficult by pressures from various constituencies, including constituencies that may favour policies that could lead to more FDI protectionism, and because national policy objectives can change over time. National FDI policy-making is, thus, a dynamic process.

## 2.5. International Rule-Making on International Investment

Alongside efforts to make the national investment climate more hospitable, governments have concluded IIAs (mostly BITs) at a rapid pace. The number of BITs exploded from 371 at the end of the 1980s to 2,926 at the end of 2014, to which 345 other IIAs (especially free trade agreements with investment chapters) need to be added, to arrive at a universe of about 3,300 IIAs (UNCTAD 2015b, 106). The principal purpose of these treaties was—and remains—to protect the assets of investors abroad and, more recently, facilitate<sup>11</sup> the operations of these investors in host countries, seeking to induce in this manner additional investment flows and the benefits associated with them.<sup>12</sup> Accordingly, IIAs have traditionally been primarily concerned—particularly from the perspective of capital exporting countries—with constraining the ability of host countries to take discriminatory action against investors, and to avoid perceived national court biases in the event of disputes.

<sup>8</sup> It was during that time that the United Nations Code of Conduct on Transnational Corporations was negotiated (Sauvant 2015). Later on, too, attitudes in selected countries were critical of incoming investment from some countries, for instance during the 1980s, when Japanese FDI was on the rise in the United States.

<sup>9</sup> For a discussion of the reasons for this change, see, *ibid.*

<sup>10</sup> See, UNCTAD, *World Investment Report*, various years.

<sup>11</sup> For discussion of the expanding role of investment liberalization in recent treaty practice, see Feldman et al. (2015).

<sup>12</sup> This is also reflected in the titles of BITs (“Agreement for the promotion and reciprocal protection of foreign investment between \_\_\_\_\_ and \_\_\_\_\_”).

In line with the principal purpose of IIAs, key treaty concepts and the protections enshrined in them were traditionally very broad. To begin with, “investors” were generally defined as any individuals and legal persons having assets abroad. “Assets”, in turn and as a rule, refer (in an open-ended manner) to any kind of assets,<sup>13</sup> including portfolio investment, intellectual property rights and certain contractual arrangements (important to MNEs that control global value chains). Similarly, key protection standards to be observed by host countries, such as fair and equitable treatment (which has become the basis of many investor claims) and indirect expropriation, were typically not defined precisely. Protection, furthermore, can be expanded through most-favoured-nation (MFN) commitments, umbrella clauses and the possibility of treaty shopping. At the same time, IIAs did not traditionally impose obligations neither on foreign investors nor, as a rule, on home country governments. And they rarely pay hard law (that is, enforceable) attention to other public policy objectives, such as sustainable development, human rights and the environment.

Matters are further complicated because the international investment regime consists of a multiplicity of legal sources and instruments. These include the multitude of IIAs, customary international law, the decisions of arbitral tribunals, state-investor contracts, various voluntary governmental, intergovernmental and non-governmental guidelines, as well as mixed voluntary/mandatory instruments.<sup>14</sup> Moreover, national law has a role to play as well. While there are many substantive similarities among (especially) IIAs, these instruments do not add up to a coherent whole. As a result, the regime governing international investment is highly fragmented, difficult to describe, hard to navigate, and exhibits instances of inconsistent lawmaking<sup>15</sup> and law-application.<sup>16</sup> Moreover, it is in constant flux. Its fragmented institutional infrastructure further exacerbates these challenges, although there are also elements of coherence (see e.g. Schill and Jacob 2013).

Finally, a crucial characteristic of the investment regime, noted above, is that investors enjoy a private right to action when seeking redress under the ISDS mechanism enshrined in the majority of IIAs, that is, they can initiate arbitration proceedings against the authorities of a host country without having to go through any government. From the perspective of international investors, this is a strong and positive, often essential, feature of the investment regime, because governments do at times infringe on treaty obligations and investors can therefore have real and legitimate grievances

about the behaviour of host country governments. In such cases, ISDS makes investors independent of their home country governments when they wish to bring a claim (unlike in the WTO). It also, significantly, makes investors independent of the judicial systems of host countries, a number of which investors may not trust fully or prefer not to use for various reasons (for example, the lack of an independent judiciary).

For host countries, however, the ISDS mechanism can potentially entail considerable risks (although it moves, at least in principle, the resolution of disputes from power-based settings to a rules-based mechanism). These begin with the fact that, while aggrieved investors have a choice between seeking remedy either under the domestic law of a host country or the applicable IIA (or both), host countries do not enjoy such a choice, as only investors can initiate the ISDS mechanism when disputes between investors and host countries arise.<sup>17</sup> And such disputes are inevitable, considering the growth of inward FDI (now amounting to a stock of US\$26 trillion); the number of international investors; the number of their foreign affiliates and the number of investors in such affiliates (all of which, depending on the applicable IIA, may have a right to initiate arbitration proceedings); the intrusiveness of FDI, involving, as it does, a wide range of interactions relating to the production process over the entire life-cycle of a project; and the various tensions within which national policy making in this area proceeds. Add to that the rising number of IIAs; their proclivity towards broad definitions of the terms “investors” and “investments”; the broad formulation of investors’ protections contained in these agreements; and the fact that violations of investor rights can take place by different branches of governments and at any administrative level (that is, not only the national level), increasing in this manner the possibilities of actions that can give rise to disagreements. The potential for conflicts of all kinds between host countries and MNEs and their foreign affiliates is therefore considerable.

Not surprisingly, the number of treaty-based investment disputes—many of them based on legitimate claims, many not—has risen markedly over the past decade, although the total remains small in light of the potential for disputes discussed earlier. Their cumulative number had reached 608 known treaty-based cases at the end of 2014, involving the governments of 99 countries from across the world (UNCTAD 2015b, 112).<sup>18</sup> Between 2003 and 2014, the number of new cases roughly averaged 40 a year, implying that the ratio of the number of cases to the stock of FDI has

<sup>13</sup> However, some IIAs place limitations on the kinds of assets that fall within the scope of treaty protections.

<sup>14</sup> For an example of a mixed instrument, see the ILO (2006) Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy.

<sup>15</sup> For instance, the manner in which fair and equitable treatment is formulated in some IIAs, that is, with or without reference to customary international law.

<sup>16</sup> For instance, how the MFN clause has been interpreted by tribunals to extend (or not) to procedural matters.

<sup>17</sup> Host country governments can however bring counter claims against treaty claims under IIAs, although they have so far not been successful in this respect. Arguably, in many cases a host country government may not need to have access to international arbitration to achieve a certain goal, as it can exercise its sovereign powers and require investors to take required action.

<sup>18</sup> To be sure, FDI flows have also grown considerably since the end of the 1990s, when the number of treaty-based investment disputes became considerably higher. By that time (say, 1999), the world’s FDI stock stood at nearly US\$5 trillion, with few treaty-based investment disputes recorded. Moreover, after reaching a peak of about US\$2 trillion in 2007, world FDI flows fell to US\$1.1 trillion and still have not recovered, while the number of disputes remained roughly at the same level. This may suggest that there is no direct relationship between the size of FDI stocks/flows and the number of disputes; rather, other factors are at work, such as the propensity of investors to utilize the dispute-settlement mechanism.

become relatively smaller (since that stock grew substantially during this period). Moreover, only a small minority of IIAs has so far been the basis of disputes, although some treaties have been the basis of more than one dispute. However, as disputes are resolved in favour of investors (although many are not<sup>19</sup> and a substantial number are settled), more claims might well be brought in the future, especially if third-party financing becomes more widely available.<sup>20</sup> On the other hand, as disputes are resolved against investors and filters are established to deal, for instance, with frivolous claims, the number of disputes might well decline. In any event, awards against responding host countries can be high, as can be the costs of arbitration, averaging around US\$10 million.<sup>21</sup>

As a result, no aspect of the international investment regime is more in the public's eye than the regime's arbitration dispute-settlement mechanism. Recurrent concerns include "inconsistencies in [arbitral] decision-making, insufficient regard by some arbitral tribunals to the host State's right to regulate in interpreting IIAs, charges of bias of the system in favour of foreign investors, concerns about the lack of independence and impartiality of arbitrators, limited mechanism to control arbitral tribunals and to ensure correctness of their decisions, and increasing costs for the resolution of investment disputes" (Schill 2015, 1). Some of these concerns may well be overstated, some are more troubling than others, and a number do not reflect a consensus view. Moreover, several of these concerns have been addressed in more recent IIAs. Yet all of them bear, rightly or wrongly, on the perceived legitimacy of the ISDS process and, thus, on that of the international investment regime itself.

A key challenge, therefore, is to prevent disputes from arising at the national level and, when they do, to resolve them at that level—and hence avoid escalation into international arbitral disputes. But even if this can be accomplished, it does not negate the need to address various weaknesses of the ISDS mechanism, or the need to improve the international investment law and policy regime in other ways. The objective should be to have a regime that is characterized by the rule of law, is aimed at the proper purpose, is considered legitimate by key stakeholders, provides for the stability and predictability<sup>22</sup> that investors and host country governments require, and thus helps meet the world's investment and sustainable development needs in the decades ahead.<sup>23</sup>

<sup>19</sup> And, in many cases, the awards were far below the damages sought.

<sup>20</sup> Third-party funding is typically not available to respondents (that is, states), as financial awards are granted only to claimants.

<sup>21</sup> According to Hodgson (2015, 749): "The average Party Costs for Claimants and Respondents are in the region of U.S. \$ 4.4 million and U.S. \$ 4.5 million respectively. To this can be added average Tribunal Costs of around U.S. \$ 750,000. The average 'all in' costs of an investment treaty arbitration are therefore just short of U.S. \$ 10 million. The median figure is notably lower, but still substantial, at around U.S. \$ 6 million."

<sup>22</sup> "Stability and predictability" are not used here to mean that the law applying to foreign investors should never change over the life of an investment -- and no investor should expect that. Rather, this term is used here in the sense that changes in laws should not be arbitrary and constant, that they should be transparent, and done in accordance with the rule of law for making changes in the law.

<sup>23</sup> In addition, the regime could also make a contribution to other global objectives, such as environmental protection and respect for human rights—or at least it could help to make sure that FDI is not inconsistent with such objectives.

# 3. Policy Options: Sustainable FDI for Sustainable Development

The international investment law and policy regime, in its current form, is a relatively young construct.<sup>24</sup> It has evolved, and continues to do so, in response to experience, pressures and changing interests.<sup>25</sup> And it has shown its impact through its investor-state dispute-settlement mechanism. Not surprisingly, the regime's strengths and shortcomings are the object of a far-reaching and, at times, passionate debate among a wide range of stakeholders. Positions range from support for the status quo on the one hand and calls for the abolition of the regime on the other, with many focussing on the need for reform—and all positions were voiced in the E15 Task Force. As to the reform approach, UNCTAD's World Investment Report 2015 has most recently developed a comprehensive action menu for IIA reform, both in terms of substance and process. More specifically, that organization identified five main challenges and outlined options to address them: safeguarding the right to regulate for pursuing sustainable development objectives; reforming investment dispute settlement; promoting and facilitating investment; ensuring responsible business conduct; and enhancing systemic consistency (UNCTAD 2015b).

To a certain extent, some of the regime's perceived weaknesses are a legacy issue. The regime was framed at a time of significant power asymmetries between capital exporting and capital importing countries, and long involved overwhelmingly unidirectional (that is, North-South) FDI flows. Today, however, it exists in an environment marked by: the imperative to promote sustainable development, including the need to halt climate change; growing economic inequality; far greater economic and political interdependence, with FDI a genuine two-way street; far greater public involvement in policy and rule-making, which has become singularly more contestable, and hence more democratic; and, a yearning for the preservation of policy space, which was by far not as constrained

when developed countries were themselves growing their economies. The reformist quest for carefully balancing the regime so as to reflect changing circumstances should be welcomed as a sign of greater maturity and fairness in international economic relations. This is so even as this quest complicates the search for consensus in rule-making.

A reformist agenda includes many issues, some more specific, and some broader in nature. Issues mentioned in the Task Force by one member or another included: the role and nature of contractual arrangements between international investors and host countries and dispute-settlement issues relating to them; alternative dispute-resolution procedures; providing a greater role for governments in the interpretation of the treaties signed by them (including during on-going arbitrations); the need to diversify the pool of arbitrators; conflict of interests for arbitrators; consolidation of claims; clarification of which entities in a global supply chain can bring a claim against a host country;<sup>26</sup> the contribution of high-standard investment agreements to equitable economic growth and sustainable development; the liberalization of entry conditions for foreign investors; the liabilities of international investors, especially in cases of egregious failings; treaty shopping; the scope of damages; the range of investors that can bring claims; the role of home country governments; and, clarification of corporate nationality.

Other issues could easily be added, and a number of them are mentioned below. A basic one concerns improved statistics on international investment. These have always been difficult to interpret, given that countries do not necessarily follow the reporting guidelines provided by the IMF, UNCTAD and the OECD. More recently, moreover, the rise of "special purpose entities" has become a major issue, as these entities primarily serve the purpose of managing the liquid assets of MNEs by channelling investment flows from one country to another; in other words, these flows

<sup>24</sup> Although the International Centre for Settlement of Investment Disputes (ICSID) had already been established in 1966, and the first BIT had been concluded in 1959.

<sup>25</sup> For an overview of the history and components of international investment law and how it operates as a complex adaptive system, see Pauwelyn (2014).

<sup>26</sup> A host country can bring a claim in its national courts only against the entity located in its territory.

do not reflect productive investment in the reporting host countries. In principle, such entities can be located in any country. Moreover, firms from a number of countries (including Brazil, China, Russia) channel a substantial share of their FDI flows through tax havens or financial centres, making it difficult (if not impossible) to determine the final location and sector of such flows. Finally, “round-tripping” continues to present a statistical problem.<sup>27</sup> Auspiciously, UNCTAD and the OECD have begun to receive data from countries that host special purpose entities (for example, Luxembourg, Hungary, the Netherlands), as well as from tax havens (especially in the Caribbean), and to correct and report the data accordingly. But this correction does not yet cover all countries, and important distortions remain. These institutions have therefore recommended that all countries report data with and without special-purpose-entities transactions.

A basic policy recommendation is thus to encourage countries to follow these reporting guidelines. It would be equally desirable if all countries reported inward FDI flows on the basis of the location of the ultimate parent firms. Implementing these recommendations—if need be with the help of technical assistance programmes undertaken by international organizations—would correct major distortions in international investment statistics. As a result, it would be easier to evaluate the all-important impact of FDI on sustainable development and hence provide a more solid basis for informed policy-making.<sup>28</sup>

The text that follows does not elaborate on the above-mentioned issues, even though they all would merit a full discussion. Moreover, the text does not deal (with a few exceptions, namely where there is a direct link to the international level) with *national* policies and efforts to attract international investment and benefit from it, as the Task Force met within an E15 project on “Strengthening the *global trade and investment system* for sustainable development.” As described in section 2 above, national policies are very important, of course, as the principal FDI determinants for the locational decisions of investors are found at the national level (World Economic Forum 2013). Rather, the text focuses on a limited number of topics that have *systemic* implications. They are discussed without going into technical details, with a view towards suggesting ways of enhancing the international investment regime to increase the flow of sustainable FDI for sustainable development—always keeping in mind that the international regulatory framework for investment (once enabling) is, as a rule, not the key determinant for the locational decisions of investors.<sup>29</sup>

The analysis that follows begins with a discussion of principles and rules, namely the purpose and contents of the international investment law and policy regime, as reflected in IIAs (section 3.1), and the facilitation of sustainable FDI flows (section 3.2). A clear purpose and clear substantive and procedural provisions are needed to reduce the likelihood of conflicts between the principal actors, specifically governments and international investors. But since conflicts can occur in any relationship, the manner in which conflicts can be prevented, managed and resolved is crucial. Accordingly, the text continues with two institutional arrangements that deserve further consideration, namely the dispute-settlement mechanism and the establishment of an Advisory Centre on International Investment Law (sections 3.3 and 3.4). So far, issues relating to objectives, contents and dispute settlement have been dealt with in individual IIAs, and improvements too can be made in each area separately. The question arises, however, whether a global phenomenon—international investment—requires a global approach, namely a multilateral/plurilateral framework on investment, a question addressed next (section 3.5). The report ends with a discussion of procedural issues, namely regarding consensus-building towards improving the international investment law and policy regime. Suggestions for action are made at the end of each section.

All these topics are discussed separately for analytical reasons, but they are closely interrelated. For example, for some, support and acceptance of an (improved) dispute-settlement mechanism depends, to a large extent, on the purpose of the regime and the rules established by it. More importantly, these topics are all central to improving the international investment regime, fostering trust in it and, ultimately, furthering its legitimacy. However, since this report was prepared under the responsibility of the Theme Leader, it needs to be reiterated that it does not reflect a consensus view among Task Force members; in fact, views within the Task Force on a number of issues discussed below varied widely.

### 3.1. Updating the Purpose and Contents of IIAs

It is encouraging that the investment regime already offers telling signs of adaptive change, moving in the direction of an expanded purpose and updated substantive and procedural provisions of IIAs, even if this process proceeds at a pace that many would like to see accelerated. Moreover, national IIA practice varies widely: a number of countries have, over the past 15 years, significantly reformed their IIA practices and model texts, while other major countries still employ texts virtually unchanged from years ago. At the same time, many IIAs are now at a stage where they could be terminated or renegotiated, and this may create opportunities for improvements. In any event, reform has to be balanced with the need to maintain the predictability of the regime as a protection device. It must also build on those elements of the regime that have been shown to work.

<sup>27</sup> For a discussion, see OECD (2015). “Round-tripping” refers to a situation in which a firm in country A establishes a foreign affiliate in country B that, in turn, subsequently invests in country A.

<sup>28</sup> Note that these corrections would lead to more accurate FDI statistics on the basis of the traditional balance-of-payments approach to such statistics. However, these corrections do not capture other important aspects relating to the measurement of FDI. For example, the statistics do not capture investment made on the basis of MNEs raising funds in the financial markets of host countries or in international financial markets outside their home countries. They also do not capture non-equity forms of control utilized by firms in regard to enterprises located abroad. Hence, FDI data substantially underestimates the share of production under the common governance of MNEs. To address these issues, governments should support initiatives that would enhance economic statistics by better capturing foreign investment and ownership.

<sup>29</sup> Moreover, it needs to be recognized that what are major concerns for one group of stakeholders do not necessarily rank as highly for other stakeholders.

### 3.1.1. Updating the purpose

#### 3.1.1.1. The need for updating

Any discussion of strengthening the international investment regime needs to begin with the very purpose of the regime (see in this context, Ortino 2015). Given the origin of IIAs, it is not surprising that its principal purpose has been, and remains, to protect foreign investors and, more recently, to facilitate the operations of investors, seeking in this manner to encourage additional FDI flows and the benefits associated with them. Arbitrators, in turn, tend to interpret these agreements accordingly.

The question is whether this relatively narrow focus can—and, for that matter, should—be maintained. The rising chorus of criticism levelled at the regime shows that reform is needed; as do the facts that a number of governments are pulling out of the regime (while others are strengthening it through the conclusion of new IIAs) or are otherwise reviewing their approach to IIAs. In particular, the quest of governments to pursue legitimate public policy objectives being perceived as transgressing on investor rights highlights that a broadening of the regime's purpose is required.<sup>30</sup> The same applies to the continuing call that foreign investors, like their domestic counterparts, also have responsibilities. Unless the regime can be made more holistic, achieves a better overall balance and reflects the interests of all principal stakeholders, it risks losing legitimacy.

Expanding the regime's purpose means that IIAs, apart from protecting international investment and facilitating the efficient operation of international investors, also recognize the need to promote sustainable development<sup>31</sup> and FDI flows that support this objective: there is little doubt that the quest for sustainable development will remain the dominant challenge on the international economic agenda in the years ahead. Additional objectives include the protection of public welfare and human rights, including public health, labour standards, safety, and the environment. In fact, especially countries with weak institutions may require dedicated international support, including through IIAs, in pursuing some of these objectives, a situation further accentuated by the international competition for investment.<sup>32</sup>

Promoting such an expanded purpose of the regime, in turn, necessitates that host and home country governments preserve a certain amount of policy space that gives them the right to regulate in the interest of legitimate public policy objectives, a right that needs to be acknowledged in a

dedicated provision in IIAs. It also means that investors commit themselves to responsible business conduct. In turn, the substantive and procedural provisions of IIAs need to reflect this broadened purpose.

#### 3.1.1.2. Progress in updating the purpose

Encouragingly, the preambles of IIAs increasingly recognize objectives other than investment protection and, through it, the promotion of FDI flows. They also reaffirm the sovereign right to regulate. Governments are furthermore beginning to recognize the importance of sustainable FDI, that is, commercially viable investment that makes a maximum contribution to the economic, social and environmental development of host countries and takes place in the context of fair governance mechanisms, as concretized by host countries and reflected for instance in the incentives they may offer—*sustainable FDI for sustainable development*.

The challenge remains of course—and it is a difficult challenge—to define sustainability characteristics of international (and domestic) investments: the more precision can be brought to the vague concept “sustainable FDI” the better.

A working group could be established to prepare, in a multi-stakeholder process, an indicative list of FDI sustainability characteristics that could be considered by interested governments seeking to attract sustainable FDI (including, for example, CO<sub>2</sub>-neutral foreign affiliates). The identification of such characteristics would also be helpful for governments seeking to encourage sustainable domestic investment.<sup>33</sup> A definition of “sustainable FDI” is also increasingly required for the resolution of investor-state disputes, as arbitral tribunals take the development impact of investments into account—as they should—when considering claims before them and, for that purpose, need criteria to evaluate such impacts. The same applies to the drafting and interpretation of IIAs, as a growing number of them make reference to “sustainable development” (Gordon et al. 2014). Norway's 2015 model BIT, in fact, speaks specifically about “sustainable investments” when it declares in its preamble: “Recognising that the promotion of sustainable investments is critical for the further development of national and global economies as well as for the pursuit of national and global objectives for sustainable development...”<sup>34</sup> And the preamble of India's 2015 model BIT seeks to “align the objectives of Investment with sustainable development and inclusive growth of the Parties.”<sup>35</sup>

<sup>30</sup> Such broadening beyond protection has already taken place when a number of IIAs moved beyond protection and towards liberalization, most notably by including pre-establishment national treatment.

<sup>31</sup> “Sustainable development” is understood as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (UN 1987, 43). For a most recent articulation, see the Sustainable Development Goals, as agreed, on 1 August 2015, by all governments for adoption by the United Nations General Assembly during its 25-27 September 2015 session (UNGA 2015).

<sup>32</sup> In the longer run, both of these concerns could be addressed through, respectively, the strengthening of domestic institutions and a multilateral agreement on investment incentives. It should be noted that one reason advanced for including ISDS in IIAs is precisely the weakness of domestic institutions.

<sup>33</sup> UNCTAD's Investment Policy Framework for Sustainable Development, the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, the Human Rights Council's Guiding Principles on Business and Human Rights, the United Nations Global Compact, and the OECD Guidelines for Multinational Enterprises could provide inspiration in this regard.

<sup>34</sup> “Agreement between the Kingdom of Norway and ... for the promotion and protection of investments”, draft version 13 May 2015. The Joint Committee foreseen in that draft has, among its responsibilities (Art. 23): “where relevant, discuss issues related to corporate social responsibility, the preservation of the environment, public health and safety, the goal of sustainable development, anticorruption, employment and human rights.” See also the recent Brazil-Mozambique bilateral investment treaty, which provides in its preamble: “Acknowledging the essential role of investment in the promotion of sustainable development, economic growth, poverty reduction, job creation, expansion or productive capacity and human development” and proceeds to say, in Article 10, entitled “Corporate Social Responsibility”: “The investors and investments shall strive to carry out the highest level possible of contributions to the sustainable development of the host State and the local community, by means of the adoption of a high degree of socially responsible practices, taking as a reference the voluntary principles and standards defined in Annex II— ‘Corporate Social Responsibility’.” The Annex then spells out in some detail these principles and standards.

<sup>35</sup> India 2015 Model BIT.

The working group could also identify what mechanisms could be used, at both the national and international levels, to encourage the flow of sustainable investment, that is, mechanisms that go beyond those used to attract FDI in general and benefit from it. At the national level, special incentives could be one of the tools used by governments for this purpose. At the international level, the working group could examine, among other things, what can be learned from various instruments established in the context of the United Nations Framework Convention on Climate Change, such as the Clean Development Mechanism, the Technology Mechanism and the Clean Technology Fund. With the adoption of the Sustainable Development Goals by the international community, this matter has acquired additional urgency.

### 3.1.2. Updating substantive and procedural provisions

#### 3.1.2.1. Clarifying key concepts

As discussed earlier, IIAs contain concepts that are not always defined precisely. Reference has just been made to “policy space” and “right to regulate.” These are elastic and sometimes politicized concepts. Care needs to be taken that the legal consequences and limits of these concepts are understood so that they are not interpreted as a *carte blanche* for governments to disregard international commitments such as non-discrimination.

Similarly, care needs to be taken that other key concepts and protections contained in IIAs are not interpreted too broadly.<sup>36</sup> If these agreements contain language that refers to general principles and rules that are open-ended, imprecise and leave excessive scope for interpretation, it may become difficult for international investors to ascertain what treatment they can expect from host countries, and for host country governments to know what they can or cannot do. Uncertainty, in turn, can increase the probability of disputes. Legal certainty—clarity of the law—should be maximized, even if the quest for eliminating all room for interpretation is obviously futile. But the less room there is for unwarranted interpretations, the better.

Accordingly, an important aspect of improving the investment regime concerns clarifying the key concepts found in IIAs, including their substantive protections (especially national treatment, fair and equitable treatment, most-favoured-nation treatment, full protection and security, expropriation), by providing tighter wording that defines as clearly as possible the sort of injuries for—and circumstances in—which investors can seek compensation, and the type of actions governments can and can not take. Such a clarification process could also make it clear under

what circumstances state-controlled entities are covered by IIAs and how to deal with special advantages they may obtain and that distort competitive neutrality, a subject that has recently won prominence as a result of the growing role of state-owned enterprises in world FDI flows.<sup>37</sup> The development and generalized use of standardized wording would help in this regard.

#### 3.1.2.2. Clarifying interrelationships

A related issue concerns the interrelationships of the international investment regime with other substantive areas of international law. International investment can have a profound impact in each of these areas.

##### A. Human rights, environment, labour, trade

Traditionally, interrelationships between the international investment regime and the international regimes dealing with human rights, environment, labour, and trade have received considerable attention (Burke-White 2015). After all, the investment regime is not a closed law system that stands in isolation from other international regimes—it is part and parcel of international law in general.<sup>38</sup> Guidance on how such linkages are to be recognized<sup>39</sup> and any conflicts between regimes are to be reconciled should be built into IIAs. Hence, it would be advisable for governments, when drafting new agreements, clearly to indicate how investment law relates to other international legal rules. A strong approach to this issue would be to condition the availability of protections in applicable IIAs on investors’ compliance with certain other rules of international law (and, for that matter, domestic law). If that were an objective, “consideration should be given to the incorporation of a ‘clean hands defence’ in bilateral investment treaties, where such a defence is triggered only by a manifest breach by the investor” (Burke-White 2015, 15).<sup>40</sup>

##### B. Taxation, investment incentives

But there are also other important areas of international law that are closely linked to international investment and, in the future, need to be taken more into account, with a view towards at least coordinating approaches. Particularly relevant here are the interrelationships between investment and taxation and between investment and incentives.

As regards the former, for instance, the worldwide approach to taxing foreign affiliates can lead MNEs to refrain from repatriating the income of these affiliates if corporate tax rates in the home country are higher than elsewhere. Lowering taxes can play a role in efforts to attract FDI. Still, international tax matters remain a separate field of

<sup>36</sup> This issue could also be approached at the national level, by clarifying the ambit of national laws and regulations.

<sup>37</sup> See, OECD Secretariat (2015). The authors suggest (p. 19) that “[i]t would therefore seem desirable to reach some form of mutual international agreement” on state-owned enterprises in the context of competitive neutrality. Since competitive neutrality can also be infringed upon in relation to private enterprises (for instance, when they receive incentives that help their outward FDI), the question arises whether such a “mutual international agreement,” if and when negotiated, should not also cover private enterprises investing abroad. For a discussion see, Sauvart et al. (2014).

<sup>38</sup> See in this context Article 31(3)(c) of the Vienna Convention on the Law of Treaties which requires that “any relevant rules of international law applicable in the relations between the parties” be taken into account in the interpretation of a treaty provision.

<sup>39</sup> In the case of multi-purpose agreements (and modern free trade agreements are of this type), it is in any event almost inevitable that interrelationships need to be addressed.

<sup>40</sup> It should be noted that elements of a “clean hands” approach were advocated in the model treaty prepared by the International Institute on Sustainable Development (Mann et al. 2006) and are contained in the 2012 South African Development Community Model Bilateral Investment Treaty Template, the 2015 Indian Model Text for the Indian Bilateral Investment Treaty and the European Union-Canada Comprehensive Economic and Trade Agreement.

international law with its own instruments, namely more than 3,500 bilateral tax treaties (OECD 2013), the OECD and United Nations Model Tax Conventions, tax information exchange agreements, and related instruments, such as the OECD transfer-pricing guidelines. Accordingly, IIAs generally exclude tax matters from their scope of application, or exclude them from the application of certain provisions (for example, national treatment and most-favoured-nation treatment).

Even under these conditions, however, tax matters have arisen in relation to IIAs, as reflected in the decisions of a number of investment tribunals. This has occurred primarily because “substantive clauses under international investment treaties can offer a better protection of the investors/ taxpayers’ rights when it involves tax disputes” (Chaisse 2015) than double taxation treaties do. And it has occurred primarily in relation to the application of the national treatment and fair and equitable treatment standards, expropriation provisions, umbrella clauses, and performance requirement provisions.<sup>41</sup> The intersection of these two legal regimes is likely to generate more policy challenges that will have to be dealt with in the future, including through provisions in IIAs that delineate more clearly the borderline between these two regimes.<sup>42</sup> At the moment, though, the main focus is on a qualitatively different set of issues, namely the G20/OECD efforts to halt the use of tax havens and achieve a better balance between avoiding double taxation and avoiding double non-taxation, as reflected in the G20/OECD project on base erosion and profit shifting.<sup>43</sup>

As to the interrelationships between investment and incentives, there is a general recognition that incentives do not constitute, as a rule, important FDI determinants (Sauvé and Soprana 2015). Yet, virtually all countries and, in many instances, sub-national units within countries, offer financial, fiscal or other incentives in the hope of influencing the locational decisions of firms. The empirical evidence shows that incentives are typically icing on the cake, at least in most instances and for most types of FDI (except, perhaps, for efficiency-seeking FDI)—unless all other country investment determinants are the same.<sup>44</sup> Policy-makers nevertheless regard incentives as a tool to attract larger investment projects, making incentives competition a global phenomenon. Not surprisingly, therefore, “host countries—both developed and developing—have repeatedly and steadfastly expressed a collective preference for regulatory inaction and the preservation of full policy immunity in respect of investment-related subsidy practices. Accordingly, neither the WTO nor international investment agreements currently feature a credible set of disciplines on the distortive effects of investment incentives” (Sauvé and Soprano 2015, 12-13).<sup>45</sup>

Given these circumstances, the best that can be done for the time being is to encourage international institutions with an interest in FDI to undertake empirical research and firm-level data gathering on the incidence and effectiveness of FDI incentives, identifying also which type of incentive may be most appropriate under what conditions, and to strengthen their technical assistance capacity in this area to advise interested governments (Sauvé and Soprana 2015, 12-13). Such an effort would also increase transparency. It may be possible, however, to arrive at basic disciplines in a regional context, as has been achieved within the European Union. Finally, as discussed in the E15 Task Force on Rethinking International Subsidies Disciplines, further reform of the WTO Agreement on Subsidies and Countervailing Measures could offer opportunities to deal with certain locational investment incentives (Horlick and Clarke 2015).

### 3.1.2.3. Progress in updating substantive and procedural provisions

#### A. Conceptual clarifications

As in the case of the purpose of the regime, progress has also been made with regards substantive and procedural provisions of IIAs. For example, some governments have updated the definition of “investment” by clarifying its scope. They have also clarified certain protections (for example, fair and equitable treatment, indirect expropriation). They have provided for consultations between the parties regarding the promotion of investment and other issues. And they are affording a greater role to treaty partners about the joint interpretation of clauses they have negotiated. Governments that have not yet done so might wish to consider whether they should do the same.

#### B. Investor responsibilities

There is also movement regarding the question of the responsibilities of investors, in the interest of promoting desirable corporate conduct and discouraging undesirable behaviour.

To begin with, host country governments, as sovereigns, can of course impose obligations on investors (both domestic and foreign), and have done so in their national laws and regulations, as well as through investor-state contracts.<sup>46</sup> Investors have to abide by them, making them liable for any infringements that might occur. Linked with this is, for example, the need for investors to undertake due diligence as part of human rights and environmental risk management. Similarly, investors have to comply with international law obligations established in specific areas, for example, corruption.<sup>47</sup>

<sup>41</sup> For a discussion of these cases see, Chaisse (2015b).

<sup>42</sup> For a recent discussion of the intersection of the international investment and tax regimes, see UNCTAD (2015b).

<sup>43</sup> With regards a clarified delineation between investment and taxation regimes, the first set of issues has to do primarily with the impact of traditional investment protection guarantees on a government’s ability to tax. The second one has to do with the fact that, under current domestic/international legal norms, companies (including foreign investors) may avoid paying taxes in particular countries—that is, it involves a situation of under-regulation. In terms of the future, one can deal with the first issue by clarifying the outcome of the overlap (that is, for example, should fair and equitable treatment limit a host country’s power to tax?), and one can deal with the second by either strengthening the regulatory work, potentially even in the context of IIAs.

<sup>44</sup> Incentives may influence the location of investment projects *within* countries.

<sup>45</sup> The GATS at least provides for an element of discipline in terms of most-favoured-nation and national treatment for subsidies, and many GATS schedules only contain relatively limited national treatment limitations in committed sectors.

<sup>46</sup> For a discussion of issues surrounding the incorporation of human rights in state-investor contracts, see OHCHR 2015.

<sup>47</sup> Disregarding them could become the basis for counter claims or trigger a “clean hands” defence.

But there is the question of the extent to which IIAs limit the ability of host countries to impose obligations on investors, or discourage them from doing so, for fear of being accused of transgressing on treaty provisions. The introduction of investor responsibilities—for investors from both traditional and non-traditional capital-exporting countries—in IIAs could remedy this situation by providing international standards, although it would of course not be easy to obtain broad consensus on such standards. In fact, “investors should be comforted by the prospect that at least some of the investment-related obligations may be subject to international law and institutions, should the host State opt to take its grievances to the international plane” (Bottini 2015). Moreover, broad consensual international standards on this matter could be helpful to countries with limited capacity to implement their own laws and regulations in this area, at least to a certain extent.<sup>48</sup>

The matter is indeed being taken up in IIAs, by including responsibility clauses and, separately and complementarily, by strengthening and developing various voluntary instruments that operate largely on the basis of naming and shaming.

For instance, the recent Netherlands-United Arab Emirates BIT enjoins the parties to promote the OECD Guidelines for Multinational Enterprises. There are also stronger ways of addressing the responsibilities of investors in IIAs (Bottini 2015). For example, future or amended IIAs could condition the availability of investor protections on compliance with applicable national and/or international instruments defining investor responsibilities when making an investment, including anti-corruption laws, as the recently concluded Comprehensive Economic and Trade Agreement between Canada and the European Union does. (This approach may also raise the interest of investors in uniform international investor responsibilities.) The 1976 OECD Guidelines for Multinational Enterprises offer an example of how a voluntary set of guidelines can be significantly strengthened over time.<sup>49</sup> Another example are the Guiding Principles on Business and Human Rights, adopted by the United Nations Human Rights Council in 2011.<sup>50</sup>

All the above are promising approaches towards finding a balance in the rights and responsibilities of international investors and governments, if not in one single instrument, then at least across several. They need to be explored further.

### 3.1.3. Options for moving forward

In brief, expanding the purpose of IIAs, providing greater clarity of key concepts where possible, acknowledging interrelationships with other legal regimes, and recognizing investor responsibilities should be part of a reform agenda. The best approach would be a combination of clarifying “the content and scope of the traditional substantive provisions of IIAs,” fine-tuning or recalibrating “the kinds of protection afforded to investors by traditional provisions” and “addressing the limited object of IIAs” (Ortino 2015, 10). Such a process would be helped by the fact that the great majority of IIAs contain certain principles and basic concepts that are sufficiently similar across treaties.<sup>51</sup>

As to the stock of existing IIAs, the Mauritius Convention on Transparency (opened for signature in March 2015; it will enter into force when ratified by three states) offers one possible solution by superimposing changes on existing treaties. For instance, governments could seek to negotiate a convention on the precise meaning of fair and equitable treatment or certain investor responsibilities, and states could sign up to it, making the agreed-upon text binding for them and their treaty partners, provided the latter have signed and ratified the convention as well.<sup>52</sup>

A working group consisting of leading international investment experts, including arbitrators and practitioners, could explore these matters in depth and propose how the purpose and contents of IIAs could best be updated, in close consultation with principal stakeholders. Such a group could benefit from the support of a consortium of leading universities from all continents, as well as other interested stakeholder organizations. The results could be presented to governments, for their consideration in future investment rule-making.

## 3.2. An International Support Programme for Sustainable Investment Facilitation

### 3.2.1. Aligning investment- and trade-support policies

One particular aspect of the broadened purpose and contents of the international investment regime deserves special attention, namely the efforts of virtually all governments to attract FDI and benefit from it as much as possible. International investment agreements are meant to help these efforts in an *indirect* manner by protecting the

<sup>48</sup> Including investor responsibilities in IIAs can also serve another function, namely, depending on circumstances, as a shield against investor claims.

<sup>49</sup> For some details, see the discussion below in the section on dispute settlement.

<sup>50</sup> Retroactively turning instruments that were designed and negotiated as voluntary instruments, such as the OECD Guidelines, into binding ones, or conditioning benefitting from IIA protections on compliance with voluntary instruments, needs to be approached with great care.

<sup>51</sup> This is what Schill (2009) described as the multilateral structures underlying international investment law.

<sup>52</sup> Pursuing this approach for transparency might have been helped by the fact that relatively few IIAs contained transparency provisions at the time the Convention was negotiated and that “transparency” is a relatively stand-alone provision. This is a situation quite different from, say, fair and equitable treatment (but not necessarily regarding investor responsibilities). There is also the issue that some of the protection standards are interlinked; hence it might be more difficult to agree on the clarification of any one standard only. Observed UNCITRAL: “The question of transparency in treaty-based investor-State arbitration is a topic of a procedural nature, and very clearly defined. In addition, very few treaties have provisions on the topic, as the trend in favor of transparency in arbitral proceedings is a relatively recent one. Those characteristics have made it easier to embark on the preparation of the Convention. If issues to be addressed are wider, substantive in nature, and already addressed at length and with variations in existing treaties, the task of preparing a convention may be more delicate. In particular, the risk of creating discrepancies by adding a new possibly ‘more modern’ regime to those already in existence should not be under-estimated” (UNCITRAL 2015, 3).

investments made. However, evidence about the extent to which IIAs induce greater FDI flows in this manner is mixed (Sauvant and Sachs 2009).<sup>53</sup> This is not surprising given the importance of the economic FDI determinants, the national FDI regulatory framework and investment promotion to attract such investment. In any event, IIAs themselves typically do not require *active and direct* efforts to encourage FDI flows and to help host countries benefit from them as much as possible. This is important in particular for developing countries, and especially the least developed among them, since most of them simply do not have the capacity to compete successfully in the highly competitive world market for FDI (IFC 2012). They need assistance—not only to obtain *more* FDI but *sustainable* FDI.

What is required, therefore, is an international support programme for sustainable investment facilitation, focused on improving *national* FDI regulatory frameworks and strengthening investment promotion capabilities (Sauvant and Hamdani 2015).<sup>54</sup> Such a programme would concentrate on practical ways and means—the “nuts and bolts”—of encouraging the flow of sustainable FDI to developing countries and, in particular, the least developed among them.<sup>55</sup> It would be situated in a context in which all countries seek to attract FDI in general, typically through national investment promotion agencies (IPAs—but increasingly also through a growing number of sub-national agencies), but it would focus specifically on sustainable FDI.

Such a programme would complement the various efforts to facilitate trade, notably those governed by the WTO-led Aid for Trade Initiative and the recently adopted WTO Trade Facilitation Agreement (TFA—which focuses on practical issues related to trade and does not deal with yet contentious issues such as the WTO-committed access conditions for agricultural and other products). In fact, in a world of global value chains, the Aid for Trade Initiative and the TFA address one side of the equation, namely the trade dimension, while an international support programme for sustainable investment facilitation would address the other side of the equation, namely the international investment dimension.<sup>56</sup> It would be unrealistic to expect that, in today’s world economy, trade facilitation alone would achieve the benefits that are being sought without investment facilitation. If anything, the interface of trade and investment calls for a close alignment of investment and trade policies.

Analogously to ongoing WTO efforts (and in support of them), a sustainable investment support programme would be entirely technical in nature, focusing on practical actions to encourage the flow of sustainable investment to

developing countries, and in particular the least developed among them, with a view towards contributing to their economic growth and sustainable development. All these efforts, in turn, require stepped-up official development assistance to strengthen basic economic FDI determinants.

### 3.2.2. Coverage

A sustainable investment support programme could address a range of subjects, beginning with transparency:

- *Host countries* could commit to making comprehensive information promptly and easily available (online) to foreign investors on their laws, regulations and administrative practices directly bearing on *incoming* FDI, beginning with issues relating to the establishment of businesses and including any limitations and incentives that might exist. Information about investment opportunities, as well as help in project development, would also be desirable. Host country governments, be they of OECD or non-OECD economies, could also provide an opportunity for comments to interested stakeholders when changing the policy and regulatory framework directly bearing on FDI or when introducing new laws and regulations in this area; at the same time, they would of course retain ultimate decision-making power.
- *Multinational enterprises*, in turn, could make comprehensive information available on their corporate social responsibility programmes and any instruments they observe in the area of international investment, such as the ILO Tripartite Declaration and OECD Guidelines and the United Nations Global Compact.
- Both *host countries and MNEs* could commit to making investor-state contracts publicly available.
- From the perspective of investors, moreover, transparency is not only important as far as host countries are concerned, but also as regards support offered to outward investors by their *home countries*. Thus, home countries (through a designated focal point) could commit to making comprehensive information available to their foreign investors on the various measures they have in place, both to support and restrict outgoing FDI. Supportive home country measures include information services, financial and fiscal incentives and political risk insurance. Some of these measures are particularly important for small and medium-size enterprises.

<sup>53</sup> For more recent studies, see, for example, Lejour and Safi (2015); Yackee (2010); Min et al. (2011); and Gómez-Mera et al. (2015). The empirical evidence is particularly mixed in the case of BITs, but (logically) different in the case of investment chapters in preferential trade and investment agreements, as these enhance both protection and liberalization and link trade to investment.

<sup>54</sup> The following text draws on that Think Piece

<sup>55</sup> See in this context also the United Nations Sustainable Development Goals (UNGA 2015). Goal 17: “Strengthen the means of implementation and revitalize the global partnership for sustainable development” with target 17.5: “Adopt and Implement investment promotion regimes for least developed countries.”

<sup>56</sup> It should be noted, however, that a sustainable investment support programme as advocated here places special emphasis on the promotion of sustainable FDI and maximizing its benefits.

On the national institutional side, IPAs, as one-stop shops, could be the focal points for matters related to a sustainable investment support programme, possibly coordinating with the national committees on trade facilitation to be established under the WTO's Trade Facilitation Agreement.<sup>57</sup> Within a country's long-term development strategy, IPAs could undertake various activities to attract sustainable FDI and benefit from it as much as possible.<sup>58</sup> They could, among other things:

- Improve the regulatory framework for investment by drawing lessons from best practices in countries that have successfully attracted sustainable FDI projects. Policy benchmarking could help in this respect.
- Establish time-limited and simplified procedures for obtaining permits, licenses etc., when feasible and when these do not limit the ability of governments to ensure that the regulatory procedures can be fully complied with by investors and government officials.
- Identify and eliminate unintended barriers to sustainable FDI flows.
- Engage in policy advocacy (part of which could relate to promoting the coherence of the investment and trade regulatory frameworks).
- Render after-investment services.
- Facilitate private-public partnerships.
- Identify opportunities for inserting the country in global value chains and targeting these.
- Promote backward and forward linkages between foreign investors and domestic firms.
- And—very importantly—find ways and means to increase the sustainable development impact of FDI in host countries.

Investment promotion agencies could also play a role in the development of investment risk-minimizing mechanisms badly needed to attract investment into, especially, various types of infrastructure. They could also have a role in the prevention and management of conflicts between investors and host countries (to be discussed below), including through providing information and advice regarding the implementation of applicable IIAs and the preparation of impact assessments to avoid that liability arises under these agreements. If conflicts arise, they could seek to resolve them before they reach the international arbitral level. Institutionalized regular interactions between host country authorities and foreign (as well as domestic) investors would be of particular help in this respect.

Finally, as in the WTO's Aid for Trade Initiative and the Trade Facilitation Agreement, donor countries could provide assistance and support for capacity building to developing countries (especially the least developed countries) in the implementation of the various elements of a sustainable investment support programme. This could begin with a holistic assessment of the various elements of the investment policy framework—economic determinants, FDI policy framework, investment promotion,

related policies—and how it is anchored within the broader context of countries' overall development strategies. The Investment Policy Reviews undertaken by UNCTAD—or the WTO trade reviews or OECD investment reviews—could provide a useful tool that could be made available to more countries. Support could focus on strengthening the capacity of national IPAs as the country focal points for the implementation of the sustainable investment support programme and the central country institutions to attract FDI and increase its benefits.

### 3.2.3. Avenues that could be pursued

There are several ways in which a sustainable investment support programme could be moved forward. One option would be to extend the Aid for Trade Initiative to cover investment as well, and fully so (it has already been expanded to cover infrastructure and some elements of investment), creating an integrated platform for promoting sustainable FDI. This would be a logical and practical approach that recognizes the close interrelationship between investment and trade. It would also be in tune with already existing international frameworks such as the WTO's General Agreement on Trade in Services (as indicated earlier, transactions falling under Mode 3 of the GATS—"commercial presence"—account for nearly two-thirds of the world's FDI stock). The initial emphasis could thus be on investment in services, with a focus on sectors key to promoting sustainable development, such as environmental services, energy, transportation, and professional services. Relevant initiatives might require a broader interpretation of the current Aid for Trade mandate. This approach could also benefit from the OECD's Creditor Reporting System that monitors where aid goes, what purposes it serves and what policies it aims to implement. The matter could be taken up at a Global Review on Aid for Trade, as a first step in an exploratory examination of the desirability and feasibility of this approach—an Aid for Investment and Trade Initiative. Alternatively, the current Aid for Trade Initiative could be complemented with a separate Aid for Investment Initiative; but, given the close linkages between trade and investment, this would be a second-best solution.

Another, more ambitious, and medium-term option would be to expand the Trade Facilitation Agreement to cover sustainable investment as well, to become an Investment and Trade Facilitation Agreement. This could conceivably be done through an interpretation of that Agreement or through amending that Agreement; in either case, member states would have to agree. A subsidiary body of the Committee on Trade Facilitation (to be established in the WTO when the Trade Facilitation Agreement enters into force) could provide the platform to consult on any matters related to the operation of what would effectively be a sustainable investment module within the Trade Facilitation Agreement. Apart from such a module complementing the Trade Facilitation Agreement, such an approach could also build on the WTO's GATS and, more specifically, its commercial presence provisions.

<sup>57</sup> In some countries, the trade and investment promotion functions are combined in one agency. Even in the absence of an investment support programme, it would make sense for the trade and investment focal points at the national level to cooperate.

<sup>58</sup> See in this context also OECD (2015b).

However, it is uncertain when the required two-thirds majority of the WTO membership will have ratified the Trade Facilitation Agreement. (Hopefully, the ratification of that Agreement will take place in the near future.) It is also uncertain how the Trade Facilitation Agreement Facility (which is linked to the Trade Facilitation Agreement and was launched in July 2014) will function in its quest to act as a financing facility to support those developing countries that are unable to access funds from other funding agencies. Moreover, member states would presumably wish to gather some experience with the operation of the Agreement before expanding it, especially since such an expansion would involve a subject matter—investment—that has a track record of policy controversy in the WTO.

A third, and also ambitious, option is for all—or a group of interested—countries to launch a Sustainable Investment Facilitation Understanding that focuses entirely on practical ways to encourage the flow of sustainable FDI to developing countries. It could be inspired by, and complement, the Trade Facilitation Agreement. Work on such an Understanding could be undertaken, in due course, in the WTO. It could also begin within another international organization with experience in international investment matters, perhaps UNCTAD or the World Bank or the OECD.<sup>59</sup> Or, a group of the leading outward FDI countries could launch such an initiative (which would, in effect, be a plurilateral approach); for instance, the top ten outward FDI economies (which include four non-OECD economies) accounted for four-fifths of world FDI outflows in 2014. The impetus could come from the G20, which could mandate the initiation of such work, should it be judged desirable to put such an Understanding in place.

Finally, the objectives of a support programme for sustainable investment facilitation can also be reached if its elements were to be incorporated in international investment agreements. Some of these agreements contain commitments by the treaty partners to consult on the promotion of investment flows between them. But few contain binding commitments in this respect. Notable exceptions are the 2015 Brazilian investment treaties with Angola and Mozambique: among other things, they mandate the establishment of “thematic agendas” for cooperation and investment facilitation, as well as dispute prevention, and the development of an institutional infrastructure, including a joint committee and ombudspersons, to implement the agreements (Brauch 2015). This is an approach that should be emulated in other IIAs, going forward—but it would be a piecemeal approach.

Every one of the above options would require careful study, discussions and consultations—much detailed substantive work still needs to be done to flesh out what aspects of “investment facilitation” could be included in such an agreement. This could be done by any of the organizations mentioned in the preceding paragraphs, or by a credible non-governmental organization or by a balanced group of experts and practitioners along the lines of the E15 Task Force. Moreover, it would be desirable if a knowledge

bank jointly organized by intergovernmental organizations with a track record in the various aspects of international investment could be established, as a depository for information and experiences available to developing countries seeking to attract sustainable FDI and benefit from it as much as possible.

#### 3.2.4. Options for moving forward

The issues mentioned for possible inclusion in an international support programme for sustainable investment facilitation, as well as the options outlined on how such a programme could be put in place, are merely illustrative. Some issues may not need to be included, while others might need to be added, and all of them need to be seen against the background of the importance of economic FDI determinants—if these determinants are unfavourable and investments are not commercially viable, even the best support programme is likely to have little effect. Concomitant productive capacity building is therefore critical.

The proposal's key premise is the importance—and urgency—of creating more favourable national conditions in host and home countries for sustainable FDI flows to meet the investment needs of the future. As governments and the private sector increasingly share this view, they need to muster the political will to put an international support programme for sustainable investment facilitation in place. A coalition of countries would need to take the initiative to move this proposal forward, perhaps prodded by interested civil society groups. Regional development banks, too, could take the initiative, considering in particular that many global value chains are regional in nature.

### 3.3. The Challenge of Preventing, Managing and Resolving Disputes

Updating the purpose and contents of IIAs and securing greater substantive clarity could reduce the importance of one source of ISDS instances. However, if disputes can be prevented, better managed and resolved at the national level, this would obviously lead to fewer disputes submitted to international arbitration.

#### 3.3.1. At the national level

Disputes between international investors and host country entities can arise for many reasons, because of actions taken (or not taken) by international investors or by governments. Disputes can be very costly for both host countries and international investors, and they can be disruptive. Sometimes, it may simply be a lack of knowledge on the part of decision-makers at the national or sub-national levels about the obligations the country has entered into. In some instances, disputes might be based on minor irritants that could be resolved relatively easily if they were brought to the attention of the proper authorities in a timely manner. However, if governments are not aware of such disputes early on and fail to manage them, they can evolve into international disputes.

<sup>59</sup> There are also other international organizations that could bring their expertise to such an effort, for example the ILO with its important focus on decent work and inclusive growth, as well as its experience with its Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (ILO 2006); the Office of the High Commissioner for Human Rights with its work on the Guiding Principles for Business and Human Rights (UN OHCHR 2011); and UNEP with its experience in environmental matters.

Parties therefore “need to develop investor-State conflict management mechanisms that can enable governments and investors to address their grievances well before they escalate into full blown legal disputes” (World Bank Group 2015). For that purpose, they need the institutional infrastructure to engage in regular government-private sector dialogues and to monitor conflicts and resolve these, preferably during an early stage. Institutions such as national investment ombudspersons and inter-ministerial committees (as, for example, in the Republic of Korea and Peru, respectively) that vet conflicts when they arise, with a view towards settling them amicably at an early stage, are helpful here.<sup>60</sup> The World Bank has begun to help countries to establish such conflict-management mechanisms, an effort that ought to be made available to as many countries as possible.

Investment promotion agencies, too, can play an important role, as part of their after-investment services, or—as part of their policy-advocacy function—by conducting IIA impact assessments and advising on the implementation of treaty commitments. Other practical and non-judicial mechanisms, such as alternative dispute-resolution approaches (for example, mediation), have a role to play as well and should be explored more in future IIAs, including by allowing respondent states to initiate such approaches.

Moreover, steps need to be taken to reduce the likelihood that contracts between international investors and host countries, including their implementation, become sources of disputes.<sup>61</sup> Such contracts can be found in particular in the natural resource and infrastructure sectors.<sup>62</sup> They may be poorly negotiated and may not reflect the best possible deal a host country could obtain had it (like, typically, its international investor counterpart) the multi-disciplinary world-class team of experts negotiating on its behalf. Contracts that are, or are seen to be, unbalanced in favour of investors are likely to give rise to conflicts when governments unilaterally take action to rectify what they consider contractual deficiencies and, in this manner, impinge on investor rights; ultimately, such actions may lead to international arbitration. Well-negotiated contracts are also of benefit to investors in that they create conditions of mutual trust and help ensure that commitments are being kept. One response to this situation is the creation of an investment negotiation support facility currently being considered by the G7 (with the encouragement of the least developed countries)<sup>63</sup>—not only as a way to arrive at well-

negotiated contracts, but also as a means to reduce the likelihood that disputes arise.<sup>64</sup> This initiative should come to fruition as soon as possible.

### 3.3.2. At the international level

It is unavoidable, though, that some disputes reach the international arbitral level. It may be possible to deal with some of them through alternative dispute-settlement mechanisms, and the use of such mechanisms needs to be encouraged further. But given the centrality of the ISDS mechanism to the investment regime, that mechanism has to be beyond reproach, and it needs to be responsive to the expanded purpose of the regime. This is not only a technical matter, but also one that has implications for the very legitimacy of the international investment regime. A number of steps have already been taken to improve this mechanism, including by enhancing its transparency, considering a code of conduct for arbitrators, dealing with frivolous claims through various filtering mechanisms, and reducing the possibility of abusive treaty shopping.

Other changes could be considered, some without fundamentally altering the current nature of the investor-state dispute-settlement mechanism, while others would lead to substantial changes. A number of them are already being pursued, especially in more recent IIAs. For example, one could require the (time-limited) recourse to domestic remedies (while making these, where necessary, a more viable option for investors) before taking recourse to international arbitration. One could give governments greater rights to issue binding joint interpretations of the IIAs they have concluded and under which claims are being brought. One could give governments the right to initiate arbitrations.<sup>65</sup> One could provide host countries access to the judiciaries of home countries under certain circumstances (for instance, in cases of bribery). One could reserve certain well-defined areas (say, issues relating to the environment) for state-to-state dispute settlement. One could abandon ISDS altogether, at least in certain contexts, such as in the case of disputes between countries with well-developed judicial systems. Or, one could expand access to this mechanism to domestic investors (perhaps using a filter).<sup>66</sup> Each of these variations poses its own challenges and opportunities, and governments would be well advised to consider a number of them with careful scrutiny and consult fully with key stakeholders.

<sup>60</sup> See, for example, UNCTAD (2011). The discussion here focuses on alternative dispute-settlement mechanisms. If any disputes were to be brought in the national court system, a concern of investors would be the independence of that system from the government.

<sup>61</sup> As of early 2015, some 18% of the cases registered under the ICSID Convention and Additional Facility Rules were registered on the basis of contracts (ICSID 2015, table 4, “Basis of Consent Invoked to Establish ICSID Jurisdiction in Registered ICSID Cases”).

<sup>62</sup> Nearly 30% of the 515 cases registered between 1972 and June 2015 with ICSID under the ICSID Convention and the Additional Facility Rules concerned natural resources (including agriculture), and another 43% involved infrastructure (ICSID Case Search Portal. <https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/AdvancedSearch.aspx>).

<sup>63</sup> See, “Leaders’ Declaration, G7 Summit, 7-8 June 2015,” p. 20, “CONNEX”. See also the Knowledge Portal developed by the Columbia Center on Sustainable Investment in connection with this project, available at [www.negotiationsupport.org](http://www.negotiationsupport.org).

<sup>64</sup> The relationship between investment contracts and IIAs has to be carefully considered. Otherwise, any improvements in the drafting of investment contracts may have little impact because of the treaty structure existing “above” them.

<sup>65</sup> But this would require that governments have a basis for a claim. On the other hand, governments have the right to initiate arbitrations and have done so when they qualify as investors under a treaty; in particular, state-owned entities have brought claims.

<sup>66</sup> The treatment prescribed in IIAs for foreign investors constitutes also good treatment of domestic investors—which, therefore, could benefit from a sort of “trickle-down” effect.

Apart from the above options, fundamental improvements to the structure of the dispute-settlement mechanism need to be envisaged. Two are singled out here, one relating to the question of further institutionalizing the dispute-settlement process, and the other relating to who should have access to it.

### 3.3.2.1. Further institutionalizing dispute settlement

The question of further institutionalizing dispute settlement arises because the current approach to dispute settlement by arbitral tribunals involves a fundamental tension: on the one hand, it is a party-owned process undertaken in an *ad hoc* manner by private individuals focused on solving individual disputes; on the other hand, these private individuals exercise quasi-public law functions in that arbitrators determine whether certain actions by governments are consistent with international obligations (sometimes even general measures affecting many actors) and, more broadly, contribute to the further development of international investment law. But they do so within a system that currently affords little ability to review decisions to correct judicial errors and ensure consistency in arbitral awards.<sup>67</sup>

In particular, a topical and urgent question is whether appeals mechanisms for the current *ad hoc* tribunals, a world investment court as a standing tribunal making the decision in any dispute-settlement case, or a combination of both should be established. Views on these questions, including within the Task Force, vary widely. Institutionalizing dispute settlement in this manner could be a major step towards improving the investment regime, comparable to the move from the *ad hoc* dispute-settlement process under the GATT to the much-strengthened Dispute Settlement Understanding of the WTO, although it needs to be taken into account, among other things, that the WTO model is based on a single set of multilateral commitments (as opposed to the multitude of diverse IIAs) and that only states—and not private actors—have access to the WTO's dispute-settlement mechanism. Such an institutional innovation could not ensure the full consistency of the application of IIAs, given that the underlying treaties are not uniform, even though these agreements share certain principles and recurrent core concepts. However, it could, over time, enhance consistency, help make the dispute-settlement process more accountable and develop a body of legally authoritative general principles and interpretations that would increase the coherence, predictability and, ultimately, the legitimacy of the investment regime.

### A. Different modalities

Several configurations and arrangements are conceivable.<sup>68</sup> For example, awards issued by the *ad hoc* panels currently used in IIA disputes could be appealed to *ad hoc* appellate bodies to correct serious errors of law and perhaps even assessments of facts made by the first-instance arbitral tribunals. Such appellate bodies could be constituted in the context of particular disputes and in a manner similar to the way in which the first-level *ad hoc* panels were established, but with a broader mandate than that of the *ad hoc* annulment committees of ICSID (which are empowered to annul only on the specific grounds of Art. 52 of the ICSID Convention). In a variation, the members of the appellate bodies could be chosen from a predetermined list of experts, preferably not by the parties to a dispute but by an independent third party. In either case, appeals could proceed under whatever arbitration rules have been chosen. One advantage of such an approach would be that appeals mechanisms could be added to the current *ad-hoc* regime.<sup>69</sup> A disadvantage is that such an approach would not necessarily increase the consistency and predictability of arbitral decisions, although, if arbitrators were to be chosen from a relatively limited pool, consistency could perhaps increase. And, of course, any appeals mechanism could, at least in the short term,<sup>70</sup> add costs and delays to processes already criticized by many as overly slow and costly.

At the other end of the spectrum, one could envisage the establishment of a single permanent and independent world investment court, staffed by tenured, professional judges and supported by a permanent secretariat made up of highly qualified investment lawyers.<sup>71</sup> It would serve as the first and sole instance for any dispute, replacing the current decentralized *ad hoc* dispute-settlement regime. It could be supplemented, in due course, with a standing appellate body. (Or such a standing body could serve for both purposes, namely a standing first-instance court for some treaties and an appellate body for others.) Decisions rendered by any of these bodies would be precedential. One advantage of such an approach would be that it would increase the consistency and predictability of decisions and in this manner help consolidate international investment law. Depending on the structure adopted, a disadvantage might be that such an approach could be seen as establishing a relatively elaborate, costly and potentially time-consuming structure in a specialized field of international economic law, although it would not necessarily be more so than the current decentralized system.

<sup>67</sup> To a large extent, this tension derives from the fact that ISDS is patterned on commercial arbitration where the two parties to a dispute are of the same nature, while in the case of ISDS, one party is a state.

<sup>68</sup> For a discussion, see Schill (2015) approaching the ISDS discussion from a comparative constitutional law perspective. For various options and suggestions, see also Kalicki and Joubin-Bret (2015).

<sup>69</sup> But there is the question of what would happen to the review mechanisms currently in existence: review under UNCITRAL's Model Law and ICSID's Additional Facility, as well as annulment under ICSID Convention cases. In the case of UNCITRAL's Model Law, this may not present major difficulties, as the Explanatory Note to the Model Law provides in para. 45 ("Application for setting aside"): "Article 34 [of the Model Law] is limited to action before a court (i.e., an organ of the judicial system of a State). However, a party is not precluded from appealing to an arbitral tribunal of second instance if the parties have agreed on such a possibility (as is common in certain commodity trades) (UNCITRAL 2008, 35, "Explanatory Note").

<sup>70</sup> If, however, a well functioning appeals mechanism system should succeed in establishing legally authoritative general principles and interpretations, both first instance and appeals proceedings may become shorter in the longer run.

<sup>71</sup> Note that the WTO's dispute-settlement mechanism does not go that far. But involvement of the WTO Secretariat's Legal Affairs Division helps ensure an element of consistency over time.

Naturally, there are variations between these two approaches. For instance, one could imagine an appellate mechanism for reviewing awards being established in the framework of a treaty between two or more parties, to review decisions of *ad hoc* tribunals. Other states would be invited to opt in to make use of that mechanism as well. In this manner, such a mechanism could be expanded in the framework of the negotiation of mega-regionals<sup>72</sup> and, eventually, be multilateralized. Any new arrangement could, in principle, be made applicable to the stock of IIAs by taking a Mauritius Convention-type approach.<sup>73</sup>

While ambitious, it is not inconceivable that any such institutional improvements in the investment regime's dispute-settlement system could be made. After all, virtually all IIAs concluded by the United States since 2002 foresee the possibility of an appellate body (although no action has been taken yet towards establishing or even discussing such a body).<sup>74</sup> The European Commission, in agreements with Canada and Singapore, has explored this approach, as reflected in the recent Comprehensive Economic and Trade Agreement and the European Union-Singapore Free Trade Agreement. Moreover, the European Commission is facing acute political pressure to improve the ISDS mechanism, notably in the context of negotiating a Transatlantic Trade and Investment Partnership (TTIP) agreement with the United States.<sup>75</sup> Importantly, the European Commission has responded to such pressure by announcing in 2015 that it seeks to introduce an appeals mechanism, in a move towards a dispute-settlement approach that would function similarly to traditional court systems.<sup>76</sup> Beyond that, the European Commission is also working towards the establishment of an international investment court and appellate mechanism that would apply to multiple agreements, and which would be a stepping-stone towards a permanent multilateral system for investment disputes (European Commission 2015, 2015c).

## B. Challenges to be overcome in considering different modalities

Any of the institutional improvements outlined above would involve significant challenges, requiring substantial research, multi-stakeholder consultations and extensive negotiations. Issues that would need to be considered include:

- What can one learn from the experience of similar arrangements in other areas, especially trade?

- What would be the costs and benefits of ad hoc appeals mechanisms vs. a permanent world investment court?
- What would the architecture of such an institution look like and how would such an institution be organized?
- How would such an institution be created and its independence from national governments be ensured?
- What would be the relationship of such an institution with existing annulment remedies?
- How would judicial appointments be made? In particular, how could it be ensured that the members are selected based on demonstrated competence on investment issues, to ensure the up-to-date technical expertise required to deal with complex international investment law matters? Related to that, how to ensure that members have expertise in related areas of the law, such as human rights and environmental law?
- For arbitrators/judges serving on an appellate body/permanent court, what level of deference would they be required to accord to joint interpretations of the parties to the applicable treaty?
- What would be the scope for appellate review (facts, law, procedure) and the scope for a standing body in the absence of harmonized rules and standards?
- Would parties to the applicable treaty have the power to reject decisions of an appellate body/permanent court through joint statements/joint interpretations?
- How would such an institution be financed?
- How would such an institutional innovation be made applicable to disputes arising under existing IIAs?
- Should such an institution be a stand-alone body or be associated with an existing institution and, if so, which one?

For example—just to mention one possibility in relation to the last of these questions—since ICSID is the single most prominent dispute-settlement venue, one could think of a treaty updating the present Convention on the Settlement of Investment Disputes between States and Nationals of Other States—an ICSID II, so to speak. It would preserve enforceability, but update any features in the current rules that might require modernization (including, for instance, expanding the possibility for counter-claims). Most importantly, such a new treaty could create a single world investment court (and appellate body) that would then be available to all governments that have signed and ratified such a treaty.<sup>77</sup>

<sup>72</sup> This approach seems to be foreseen in the Trans-Pacific Partnership Agreement.

<sup>73</sup> As few IIAs to date contain references to an appeals mechanism, it may—in principle—be relatively easy (as in the case of transparency) to pursue a Mauritius Convention-type approach—provided, of course, the political will is present to establish such a mechanism. Observed UNCITRAL: “Depending on the manner in which an appeal mechanism or an investment court would be set up, a convention could indeed be an appropriate solution” (UNCITRAL 2015, 4).

<sup>74</sup> Agreements by other countries, too, contain provisions to the effect that the parties may consider the idea of an appellate mechanism in the future. See, for example, the 2014 Canada-Korea Free Trade Agreement and the 2014 Canada-Honduras Free Trade Agreement. The investment chapter in the Free Trade Agreement between the Government of Australia and Government of the People's Republic of China requires the parties (Art. 9.23), within three years of entry into force, to “commence negotiations with a view to establishing an appellate mechanism.”

<sup>75</sup> So far, however, there is no sign of United States interest in the recent European Union position on an appeals mechanism.

<sup>76</sup> See, European Commission (2015). On 8 July 2015, the European Parliament adopted a resolution that, among other things, supported the European Commission in its efforts “to replace the ISDS system with a new system for resolving disputes between investors and states which is subject to democratic principles and scrutiny, where potential cases are treated in a transparent manner by publicly appointed, independent professional judges in public hearings and which includes an appellate mechanism, where consistency of judicial decisions is ensured, the jurisdiction of courts of the EU and of the Member States is respected, and where private interests cannot undermine public policy objectives” (European Parliament 2015, operating para. 2.(d) (xv)). See also European Commission (2015c).

<sup>77</sup> Another alternative would be to modify certain parts of the ICSID Convention between certain of the parties only, as per Art. 41 of the Vienna Convention on the Law of Treaties, *op. cit.*

### 3.3.2.2. Access to dispute settlement for governments and other stakeholders

Earlier in this paper, the point was made that the contents of IIAs need to be expanded to include responsibilities of foreign investors,<sup>78</sup> and it was shown that a number of such agreements are moving in that direction. If this should indeed become more common, governments arguably should have direct access to the regime's dispute-settlement mechanism, and not only by way of counter-claims. The question would also arise—and this would be a profound, challenging and very ambitious change—whether the dispute-settlement process should then be opened up further to other stakeholders too.

With regards to opening up to other stakeholders, something similar (although by far not as consequential) occurred in the context of the implementation of the voluntary OECD Guidelines for Multinational Enterprises, addressed to MNEs operating in or from adhering countries. The responsible OECD Committee has the mandate to monitor the implementation of the Guidelines and to clarify them in the light of concrete cases brought to its attention. Although the Committee cannot pronounce itself on the behaviour of individual enterprises, it can take cases as illustrations of issues that need a clarification of the meaning of the Guidelines, thereby giving strength to the implementation of the instrument. This clarification process has always been open to governments, the business community (via the Business and Industry Advisory Committee to the OECD) and trade unions (via the Trade Union Advisory Committee to the OECD). During the 2011 review of the Guidelines, the consultative status with the Investment Committee was extended to OECD Watch, the OECD Investment Committee's recognized representative of civil society organizations. As a result, non-governmental organizations (via OECD Watch), as well as other stakeholders, can now bring cases to the attention of the OECD's Investment Committee, for the purpose of clarifying the Guidelines (OECD 2011). However, the key mechanism for the implementation of the Guidelines remains the National Contact Points established in each country that adheres to the Guidelines. This mechanism has been profusely used by civil society and trade unions: more than 300 complaints have been submitted to the national contact points since 2000.<sup>79</sup> The implementation process of the OECD Guidelines is now open to all key stakeholders, enhancing in this manner its effectiveness, transparency and legitimacy.

Such an extension of the investment regime's dispute-settlement mechanism—be it to allow governments to be claimants but especially to give other stakeholders more access to this mechanism—would raise many questions that would have to be examined carefully. But steps in this direction would profoundly change the nature of the international investment dispute-settlement process

by turning it from an *investor-state dispute-settlement mechanism* into an *investment dispute-settlement mechanism*.<sup>80</sup> This, in turn, could dramatically modify the dynamics of the current international ISDS discussion, with major implications for enhancing the legitimacy of the regime in the eyes of important stakeholders, while building on what has already been established.

### 3.3.3. Options for moving forward

In brief, however challenging the task of improving the current dispute-settlement mechanism may be in terms of overcoming numerous political and technical difficulties, embarking on the process of exploring how this could be done with a view towards developing a better mechanism would send a strong signal that governments recognize that this mechanism requires improvement. This is not merely a technical question but (as the public discussions around ISDS show) a matter of what is considered fair by public opinion.

Discussions of the range of issues relating to this matter are already underway in a number of governmental and non-governmental forums, ranging from the European Parliament to various academic conferences. These should be expedited and, hopefully, will lead to a fruitful conclusion. All interested stakeholders should be heard and all pertinent issues should be addressed. In-depth discussions in informal forums can make valuable inputs into governmental deliberations.

## 3.4. An Advisory Centre on International Investment Law

### 3.4.1. Rationale

A similarly strong signal demonstrating the will to enhance the legitimacy of the dispute-settlement process—and, with it, the investment regime—would be sent if the ability of more vulnerable countries to defend themselves as respondents in investment disputes would be improved.<sup>81</sup> Conversely, a dispute-settlement mechanism that does not provide a level playing field for the disputing parties can easily be seen as compromised, undermining its very legitimacy. Access to justice must not only be seen as fair, it has to be fair in its very *modus operandi*.

Claims against host country governments can reach hundreds of millions of dollars, host country regulations may be challenged and the reputation of a country as an investment location may be at stake. And, as noted, the annual number of claims is substantial, and litigating them is expensive, especially as disputes are becoming more complex. There is also the risk that governments may have to assume the litigation costs of the claimants if they lose a case. The advent of third-party funding further accentuates the imbalance for more vulnerable countries, as such funding provides an additional source of finance to potential claimants.

<sup>78</sup> Presumably, the responsibilities of national investors would be the same or quite similar. See in this context for example the Guiding Principles on Business and Human Rights (UN OHCHR 2011).

<sup>79</sup> See, <http://mneguidelines.oecd.org/database/> as of 5 May 2015.

<sup>80</sup> Conceivably, such a mechanism could also have the function to issue, upon request, advisory opinions. The International Court of Justice has such a function. Although such opinions are not binding “the advisory opinions of the Court nevertheless carry great legal weight and moral authority.” See, <http://www.icj-cij.org/jurisdiction/index.php?p1=5&p2=2>.

<sup>81</sup> This matter is dealt with separately here, as it is not so much a matter of access to the dispute-settlement mechanism, but rather a matter of being able to utilize it properly.

Least developed countries, in particular, typically do not have the in-house legal expertise to defend themselves adequately—in fact it may not be the best use of scarce resources to build such expertise, as few countries need to defend themselves in more than one or two cases at a time. At the same time, such countries often lack the experience of how to handle disputes, including the specific requirements of the ISDS mechanism. And many simply may not have the financial resources to hire the required expertise, which also does not help the efficiency and quality of the arbitration process—an important consideration since the bulk of the litigation costs typically relate to counsel and expert witnesses.

This puts many countries in an asymmetric situation whenever a dispute arises, beginning with a possible proclivity to settle disputes in which they could potentially prevail, or knowing when to settle during an early stage of a dispute when they usefully could do so, simply because they do not have the required sophistication or the resources to defend themselves.

An independent Advisory Centre on International Investment Law would help to establish a level playing field by providing administrative and legal assistance to respondents that face investor claims and are not in a position to defend themselves adequately (Joubin-Bret 2015). The WTO experience provides useful inspiration: when, after the creation of the WTO, the number of disputes brought before this institution rose, the (independent) Advisory Centre on WTO Law was established in 2001—the principal outcome of the tumultuous Seattle WTO Ministerial Meeting. It advises its developing country members on all issues relating to WTO law, including by assisting its members through all stages of the WTO’s regular panel and Appellate Body proceedings as complainants, respondents and third parties. The Advisory Centre provides its services through its own staff or through outside counsel at reduced rates.

Similar considerations apply to small and medium-size enterprises, as these too typically do not have the expertise and resources to bring claims. They too require support. Costs and delays could become even more of an obstacle if an appeals mechanism were to be established. A small-claims settlement mechanism, with an expedited process, set deadlines and sole arbitrators, could be of help in this regard.

Independently of these two institutions (the Centre and the small-claims mechanism), and as a low-cost alternative dispute-settlement mechanism of potential value to both governments and (in particular small) firms, an International Investment Ombudsperson could be designated, cooperating with an *ad hoc* ombudsperson in a respondent state. Such persons would have to be independent and highly esteemed by both governments and the private sector, to command the respect that would be needed to arrive at an informal settlement of a dispute.

### 3.4.2. Issues

Establishing such a Centre in the investment field would require answers to a number of questions (Joubin-Bret 2015). For example:

- Which countries should be able to benefit from its services—all non-OECD economies or only the least developed countries? Or also OECD countries? (Governments in all regions have been respondents.)
- Should the Centre establish working relations with national conflict management mechanisms?
- Should advice include assistance in evaluating whether a particular claim is strong and the government should therefore settle?
- Should the Centre play an active role during the cooling-off period and during mediation procedures?<sup>82</sup>
- Should the Centre’s mandate include supporting—or even representing—respondents in actual dispute-settlement proceedings or only supporting and advising on international investment law and dispute-settlement procedures?
- Should any support cover both investor-state and state-state disputes?
- Should the Centre provide technical assistance to governments, for example, for capacity building through legal training in matters related to ISDS or, broader, the negotiation of IIAs with dispute-settlement provisions?
- Should it offer alternative dispute-settlement services, including mediation?
- At what price should its services be made available? <sup>83</sup>
- How would costs be covered?

There are more issues that need to be considered—and the closer any assistance comes to actual participation in litigation, the more difficult it may become for some countries to support the establishment of such a Centre. At the same time, the central challenge is to identify broadly acceptable ways that gives all countries a fair chance to defend themselves adequately in disputes to which they are party.

### 3.4.3. Options for moving forward

In conclusion, the WTO Advisory Centre has done valuable work, contributing its share to enhancing the legitimacy of the international trading system. An Advisory Centre on International Investment Law—which would suitably complement the reform of the ISDS mechanism—could do the same thing for the international investment regime. To make this happen, “it is essential for a couple of champion-countries to get together to launch an initiative at the right time and with the right level of political support. The current turmoil around investment arbitration could provide the opportunity for like-minded countries to work together towards establishing such an advisory centre, inviting all other countries to join them in their initiative” (Joubin-Bret

<sup>82</sup> Close to a third of all known disputes have been settled before a final award had been rendered.

<sup>83</sup> Maximum charges of the Advisory Centre on WTO Law for a complainant or respondent for consultations, panel proceedings and appellate body proceedings amount to (in Swiss Francs) between CHF138,000 (US\$141,000) and CHF277,000, depending on the category of member country requesting assistance; for least developed countries, that amount is 34,000; see, <http://www.acwl.ch/e/disputes/Fees.html>. These fees are also binding for external counsels, in case they are in conflict. Minimum free market rates for litigating a relatively simple WTO dispute through to the basic panel report stage may range from US\$250,000 to US\$750,000 (Bown and Reynolds 2015).

2015, 21). The process of clarifying the issues surrounding the creation of an Advisory Centre on International Investment Law should begin now, with a view towards bringing it into being in a short period of time.

It would be very desirable if a few governments particularly concerned about the legitimacy of the international investment regime would assume a lead role in establishing such a Centre and a small-claims settlement mechanism for small and medium-size enterprises. They could be supported by a non-governmental organization with a track record of work on the international trading system, and they could seek to draw on the experience of intergovernmental organizations with an interest in this subject.

### 3.5. A Multilateral/Plurilateral Framework on Investment

The discussion so far has focussed on individual—but key—aspects of the international investment law and policy regime and how they could be improved. But one could also take a holistic approach to the governance of international investment, namely to negotiate a comprehensive universal framework on international investment, preferably a multilateral framework on investment (MFI), possibly starting with a plurilateral framework on investment (PFI) that would be open for future accessions by other states. Circumstances may be propitious for such an undertaking (Shan 2015, with comments by Gary Hufbauer and Tyler Moran).

#### 3.5.1. Changing interests

Most importantly, the constellation of interests of countries has changed profoundly over the past decade, and in a manner that favours a more universal approach. When earlier efforts at the multilateral level were undertaken, there was a clear distinction between home and host countries, typically along North-South lines. Now, as documented earlier, firms in a rising number of non-OECD economies (and particularly the biggest among them) are becoming important and dynamic outward investors. The implication is that emerging markets define their policy interests no longer only defensively as host countries, but also offensively as home countries interested in protecting their investors abroad and facilitating their operations. This can be exemplified by the change in approach of China when, in the context of the United States-China Strategic and Economic Dialogue, the country agreed in July 2013 to continue negotiating a BIT with the United States on the basis of pre-establishment national treatment and the negative list approach to exceptions from such treatment. Both approaches had long been resisted by China.

Similarly, traditional capital-exporting countries have “rediscovered” that they are also important host countries, including for more and more investors headquartered in emerging markets, and that they are increasingly respondents to international arbitration claims. The implication is that they define their policy interest no longer

only offensively as home countries, but also defensively as host countries interested in maintaining adequate policy space to be able to pursue legitimate public policy objectives. This can be exemplified by the change of approach by the United States when, in revising its model BIT, it narrowed protections afforded to foreign investors—a significant conversion for a country that had long led efforts to provide full protection to investors and facilitate their operations.

The convergence of policy interests between home and host countries, as well as between developed countries and a growing number of emerging markets, should facilitate reaching a universal agreement—if there is the political will to pursue such an objective.

Moreover, it is significant that governments continue to show a great willingness to make rules on international investment, as reflected in the proliferation of IIAs. (In this context, it would be desirable to establish a formal international repository of IIAs where countries would deposit their agreements of this kind.<sup>84</sup>) In particular, a number of ongoing important IIA negotiations are likely significantly to advance a more harmonized approach to investment-rule making: “recent treaty practice by States negotiating the TPP [Trans-Pacific Partnership], RCEP [Regional Comprehensive Economic Partnership], and U.S.-China BIT, as well as the recent Pacific Alliance agreement, creates a significant opportunity for the harmonization of the international investment law regime at a regional, Pacific Rim level” (Feldman et al. 2015, Conclusions). The negotiations of a number of BITs between important countries (in addition to the China-United States BIT),<sup>85</sup> as well as the negotiations of the Transatlantic Trade and Investment Partnership between the European Union and the United States, could lead to a more harmonized approach to investment-rule making and, de facto, to common rules on international investment. Together, these negotiations represent significant opportunities—which should be fully utilized—to shape the investment regime by narrowing the substantive and procedural international investment law and policy differences between and among the principal FDI host and home countries. They could set standards that might considerably influence future investment rule-making in general. If this should occur, the result of these negotiations could become important stepping-stones towards a subsequent universal investment instrument.

#### 3.5.2. Challenges

A multilateral/plurilateral framework on investment would seek to define, in a coherent and transparent manner, the relationship between governments and international investors and provide the predictability and stability that long-term investment needs, with a view towards facilitating the flow of sustainable FDI for sustainable development. Global rules for a global economy: “In a globalising economy, industry needs a truly global framework for investment, set up in a forward looking and strategic manner and able to cope with a diverse and constantly changing reality” (Oberhänsli 2015, 6).

<sup>84</sup> To date, UNCTAD has the most extensive collection of IIAs, and countries could easily build on that resource.

<sup>85</sup> These include the negotiations of BITs between China and the European Union, India and the United States, the European Union and India.

Starting from the need to promote sustainable FDI for sustainable development draws attention to the most comprehensive recent effort in this respect, UNCTAD's Investment Policy Framework for Sustainable Development.<sup>86</sup> It consists of national policy guidelines, options for IIAs negotiations and an action plan for promoting investment in sustainable development; it has been developed to facilitate the formulation of a new generation of investment policies and constitutes a “tool-box” that can be used by negotiators (UNCTAD 2012).<sup>87</sup> Be it multilateral or plurilateral in character, a framework would need to establish a strong basic set of rights and obligations to be observed by all signatories, be they small or big countries. If achievable, it could avoid the difficulties that arise from a fragmented regime that consists of a multitude of IIAs, both for international investors that operate in a multitude of jurisdictions (each with its own varying commitments in IIAs), and for governments that may see some of their objectives frustrated by treaty shopping on the part of some international investors.<sup>88</sup> Such a framework could also reduce the need of negotiating separate agreements that, together with the existing agreements, would eventually amount to a holistic framework on international investment.

Naturally, negotiating a universal framework would face considerable challenges, given the unsuccessful efforts of the past,<sup>89</sup> the wide range of views and the considerable passion surrounding IIAs; this could be particularly the case if some stakeholders anticipated that the result would merely be a lowest-denominator agreement. These challenges include determining the advantages and disadvantages of a universal framework and the challenges involved in crafting a high-standards agreement among a multiplicity of potential signatories.

There are also the questions of what would constitute the right balance of rights and responsibilities that various stakeholder groups might wish to see, and of where such a framework could be negotiated.<sup>90</sup> One would furthermore have to consider whether there could be, to begin with, different obligations based on the level of development (an approach pursued, for example, in the context of the WTO's Trade Facilitation Agreement). And there would be the question of whether a plurilateral/multilateral agreement would supersede, for signatories, their investment commitments in existing IIAs, or merely provide a commitment-floor for all signatory countries (and possibly fill gaps in older IIAs), including for those countries that do not have IIAs. Similarly, there is the question of how

such a framework would coexist with existing multilateral disciplines, for instance under the GATS in the WTO. A great number of additional issues would require clarification if governments should decide to embark on negotiating a plurilateral or multilateral investment framework.

Overall, a multilateral/plurilateral framework on investment would establish consistent, transparent and predictable governance of the relations between international investors and governments. It would build not only on old IIAs between and among developed and developing countries, but also on newer ones involving these countries (including the biggest developing countries), on IIAs between and among developing countries themselves, and on IIAs between and among developing countries and economies in transition—firmly establishing in this manner the rule of international investment law.

### 3.5.3. Options for moving forward: how to do it?

Given these and many other questions, it would be desirable to begin a process of exploring the possibility of negotiating an international framework on investment, ideally of a multilateral nature. This may be particular pertinent in light of the July 2015 decision by the Third International Conference on Financing for Development to mandate UNCTAD to work with member states to improve IIAs<sup>91</sup> and the experience of that organization in this area, not least in its comprehensive recent effort to facilitate the formulation of a new generation of investment policies through its Investment Policy Framework for Sustainable Development.

On the other hand, “the WTO offers the best platform for trade and investment regimes to be combined and consolidated, as a unified system providing systematic legal and institutional support for the future growth of GVCs [global value chains]” (Shan 2015, 20. See also, González 2013, 8), turning that organization into a World Investment and Trade Organization. If this course were to be pursued, the WTO's Working Group on the Relationship between Trade and Investment could be reactivated in due course,<sup>92</sup> or a new working group could be established. Another alternative is to build on existing agreements, especially the WTO's General Agreement on Trade in Services, to cover other types of investment and obligations; for example, Mode 3 could be taken out of that Agreement and made the core of a separate agreement, capitalizing on the GATS' core disciplines relating to, in particular, national treatment and most-favoured-nation treatment and the specific market-access commitments already agreed upon. Or one

<sup>86</sup> For an earlier effort, see the model treaty, referred to supra, prepared by the International Institute on Sustainable Development (Mann et al. 2006).

<sup>87</sup> The Framework was updated in 2015 with two new components: an action plan for investing in the sustainable development goals and a new pre-establishment section in the IIA part (UNCTAD 2015).

<sup>88</sup> For instance, if some governments introduce certain changes in their bilateral agreements, investors that are not comfortable with these could conceivably bypass these changes by investing from a third country.

<sup>89</sup> Recall the unsuccessful effort among the like-minded members of the OECD to negotiate a Multilateral Agreement on Investment about 20 years ago, when negotiators were unable to reach agreement on fundamental principles for such an agreement. Similarly, subsequent efforts in the WTO were abandoned.

<sup>90</sup> Negotiations would not necessarily have to take place in one of the existing institutions. One precedent is the negotiations of the Framework Convention on Climate Change: the negotiations did not take place in the framework of UNEP, but rather were serviced by a stand-alone independent interim secretariat that was not part of the United Nations structure.

<sup>91</sup> See para. 91 of the Addis Ababa Action Agenda (UN 2015), which states: “We request UNCTAD to continue its existing programme of meetings and consultations with Member States on investment agreements.”

<sup>92</sup> This would require a reversal of a decision taken on 1 August 2004, by the WTO General Council (item 1.(g)): “Relationship between Trade and Investment, Interaction between Trade and Competition Policy and Transparency in Government Procurement: the Council agrees that these issues, mentioned in the Doha Ministerial Declaration in paragraphs 20-22, 23-25 and 26 respectively, will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round” (WTO 2004).

could begin negotiating in an area for which it might be relatively easier to reach consensus, such as sustainable investment facilitation. There might also be the possibility that the international investment court and appellate mechanism sought by the European Commission could become a stepping-stone towards a permanent multilateral system for investment disputes, which, in turn, could become the nucleus around which a universal framework could be built.

If a truly universal and comprehensive strong investment framework is considered out of reach at this time, a plurilateral framework on international investment negotiated in a transparent manner could serve as a first step in that direction.<sup>93</sup> Following the example of the Trade in Services (TiSA) Agreement, it would be an agreement negotiated by interested parties that would be open for future accessions by other states.<sup>94</sup> There could be transition periods with support provided to those countries that wish to reach the standards over time, with the main principles of the framework being recognized as useful building blocks for national, regional and global regimes.

The situation may be favourable for such an initiative, in particular if the China-United States BIT should be concluded expeditiously. If that should be the case, the most important home and host countries among developed and developing countries would have negotiated an agreement that could serve as a template that could be taken forward. For example, the 2016 G20 summit in China would then “provide a good opportunity for the issue of [a] MFI/PFI to be tabled for consideration by world leaders” (Shan 2015, 2).<sup>95</sup> (China will chair the G20 in 2016.) A critical mass of countries would be needed to begin such an effort.

Depending on the arrangements, a process that could lead to a comprehensive universal framework could be serviced (individually or together) by the secretariats of a number of international organizations having relevant expertise, including those of UNCTAD, the WTO, the World Bank, UNCITRAL, and the OECD, as well as perhaps some regional institutions such as the Asia-Pacific Economic Cooperation forum. Wherever such a process should take place, it should be a structured process, undertaken with input from the principal stakeholders. It could focus on an examination of the range of issues that would need to be addressed in a universal framework (including by comparing and analysing key provisions in major recent IIAs), with a view towards recommending how it could be brought about. The clarifications that such an effort could generate would also be helpful for improving investment rule-making at the regional and bilateral levels.

<sup>93</sup> See, Hufbauer and Moran (2015, 6), who suggested to “[c]onsider launching negotiations for a plurilateral Investment Facilitation Agreement (IFA) that would supplement (not supersede) provisions in BITs and bilateral FTAs. Among other subjects, the IFA would address minimum standards for IPR [intellectual property rights], pre-establishment, national treatment, and compensation for expropriations.” According to them, a plurilateral agreement “should be launched with a small number—perhaps not more than a dozen—WTO members that are both large home countries for outward FDI and large host countries for inward FDI. A small group of this nature is more likely to reach agreement, while fairly representing the interests of host countries, home countries, and MNCs.” See Hufbauer and Moran comments in Shan (2015, 25). Echoed Shan: “the time is ripe to seriously consider a MFI, perhaps starting with a transitional plurilateral framework on investment (PFI)” (Shan 2015, 2)

<sup>94</sup> The negotiations of the Trade in Services Agreement were not serviced by the WTO Secretariat. Moreover, while these negotiations were plurilateral, they were not plurilateral in the sense of plurilateral agreements covered by the Marrakesh Agreement (such plurilateral agreements would need to be accepted by consensus by all WTO members, without however creating either rights or obligations for members that have not accepted them); rather, TiSA will be presented in the WTO as a free trade agreement under Art. V of GATS. For a discussion of this agreement, see Sauvé (2014).

<sup>95</sup> See in this context also Lin (2015). The author suggests that China, which is taking over the leadership of the G20 in 2016, should seek consensus “on a working framework for achieving this multilateral investment agreement for development. This framework could lay out a concrete timeline for achieving specific milestones. For example, one milestone could be the achievement of a non-binding investment facilitation framework. Most importantly, the core of the agreement should include a non-binding principle while highlighting inclusiveness, and emphasize an overarching commitment to fostering economic growth for developing.”

# 4. Next Steps: An Informal and Inclusive Consensus-Building Process

The growth of FDI and MNE activities, the emergence of an integrated international production system and the state of the international investment law and policy regime have given rise to a number of challenges that will need to be addressed in future investment rule-making. As the public debate about the investment regime and the debate within the international investment law community suggest, this has become a matter of urgency. Enhancements in the regime should be sought subject area by subject area, when negotiating individual IIAs. Where new initiatives need to be taken, they should be launched as soon as possible. Finally, preparations for the negotiation of a comprehensive universal investment framework should be seriously considered.

In the end, any systematic process to enhance the international investment law and policy regime needs to be government-led and -owned.

However, considering the range of stakeholders involved in international investment matters, it would be advisable to launch an (accompanying) informal but inclusive confidence-, consensus- and bridge-building process on how to address the fundamental issues confronting the international investment community, a number of them analysed in this report. Such a process should take place outside an intergovernmental setting, to encourage a free and open discussion of all the issues involved.<sup>96</sup> It could be a process organized by a credible non-governmental organization with a track record on work on the global trade and investment system, perhaps in cooperation with a consortium of academic institutions from all continents and the support of a few individual countries particularly interested in this subject. It should take a holistic view of what needs to be done, drawing on the important work carried out in recent years by established international organizations. It should identify systematically any weaknesses of the current regime and advance concrete proposals on how to deal with them—not only regarding the relationship between governments and investors, but also with a view towards increasing sustainable FDI flows and the benefits of these flows. It would have to be an inclusive and transparent process that involved the principal stakeholders to ensure that all issues are put on the table and all key interests are taken into account.

The outcome of such a process could be a draft framework that could be made available to governments to use as they see fit. In any event, it should be made available widely, to help governments to enhance the international investment

law and policy regime as the broadly accepted enabling framework for increased flows of sustainable FDI for sustainable development.

## Conclusions

The international investment law and policy regime is in flux. Like any regime, it can be improved, in a careful and constructive process that builds on what has worked. This presents challenges and opportunities. Serious thought needs to be given to how the regime governing the relations between governments and international investors in an area that constitutes the most important form of international economic transactions in the globalizing world economy can be updated and enhanced. The regime needs to be more responsive to the requirements of today's world. It also needs to be responsive to the requirements of the world as it is emerging in light of the further growth of FDI, the proliferation of MNEs and their foreign affiliates, the emergence of an integrated international production system, and the imperative to move to a sustainable model of development. Ultimately, it needs to be responsive to the expectations that its key stakeholders have regarding the regime.

At the end of this process of enhancement, such an effort should yield a regime in which multilateral investment law regulates with a clear purpose and well-defined rules the relations between governments and international investors, each with their own rights and responsibilities, and in harmony with other international regimes addressing other important objectives. Such a regime should be at the service of sustainable development, with special support for developing countries (and especially the least developed among them) to help them attract sustainable FDI and benefit from it as much as possible—substantially higher FDI flows are needed to meet the investment needs of the future and support the growth of the world economy. While governments respect property rights, they maintain the sovereign right to regulate in pursuit of legitimate public policy objectives. An institutionalized, inclusive and credible dispute-settlement mechanism would enforce the regime, with assistance available to countries in need for such assistance and special arrangements made to provide enhanced access to justice for small and medium-size enterprises.

Developing the regime in this direction is not only important for the regime to remain useful, but also to increase its legitimacy and, more generally, promote the rule of international law in a manner that reflects the interests of all key investment stakeholders.

<sup>96</sup> As the saying goes concerning any intervention of government officials in international organizations: “Anything you say in an intergovernmental forum can be held against you later on.”

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The papers commissioned for the E15 Task Force on Investment Policy can be accessed at <http://e15initiative.org/publications/>

# Annex 1: Summary Table of Main Policy Options

Policy option	Current status and gap	How to get there
<b>Updating the purpose and contents (substantive and procedural provisions) of IIAs</b>		
<b>1. Broaden the regime’s purpose to include promoting sustainable development and other key public policy objectives, including the protection of public welfare and human rights.</b>	<ul style="list-style-type: none"> <li>- The principal purpose and narrow focus of the international investment regime has been and remains to protect foreign investors and, more recently, to facilitate the operations of investors, seeking in this manner to encourage additional FDI flows.</li> </ul>	<ul style="list-style-type: none"> <li>- Constitute a working group of leading international investment experts, including practitioners and arbitrators, to propose how the purpose and contents of IIAs could best be updated, in close consultation with principal stakeholders, supported by a consortium of universities from all continents as well as other interested stakeholder organizations.</li> <li>- Present the results to governments for their consideration in future investment rule-making.</li> </ul>
<b>2. Recognize, in a dedicated article in IIAs, the need for adequate policy space and the right to regulate.</b>	Same as above.	Same as above.
<b>3. Clarify key concepts in IIAs, including their substantive protections.</b>	<ul style="list-style-type: none"> <li>- Concepts such as “policy space” are elastic. Care needs to be taken that the legal consequences and limits of these concepts are understood.</li> <li>- There is a need for tighter wording that clearly defines the sort of injuries for (and circumstances in) which investors can seek compensation, and the type of actions governments can and cannot take.</li> <li>- Key substantive provisions to be clarified include national treatment, fair and equitable treatment, most-favoured-nation treatment, full protection, and security.</li> </ul>	Same as above.
<b>4. Clarify interrelationships with other international law regimes (e.g. human rights, environment).</b>	<ul style="list-style-type: none"> <li>- Guidance on how such linkages are to be recognized and any conflicts between regimes are to be reconciled should be built into IIAs.</li> <li>- The adoption of a “clean hands” defence should be considered in investment treaties.</li> </ul>	Same as above.
<b>5. Delineate more clearly the borderline between the investment and tax regimes.</b>	<ul style="list-style-type: none"> <li>- The intersection of these two legal regimes is likely to generate more policy challenges that will have to be dealt with in the future.</li> </ul>	Same as above.
<b>6. Encourage empirical research and firm-level data gathering on the incidence and effectiveness of FDI incentives.</b>	<ul style="list-style-type: none"> <li>- There is a general recognition that incentives do not constitute, as a rule, important FDI determinants. Yet virtually all countries (and many sub-national units) offer financial, fiscal, or other incentives in the hope of influencing the locational decisions of firms.</li> </ul>	Same as below.

Policy option	Current status and gap	How to get there
7. Establish a working group to prepare in a multistakeholder process an indicative list of sustainable FDI characteristics.	<ul style="list-style-type: none"> <li>- With the adoption of the Sustainable Development Goals by the international community, this matter has acquired additional urgency.</li> <li>- Governments seeking to attract sustainable FDI could use the indicative list. It could also be of use to arbitrators.</li> </ul>	<ul style="list-style-type: none"> <li>- The working group could identify what mechanisms could be used, at both the national and international levels, to encourage the flow of sustainable investment – i.e. mechanisms that go beyond those used to attract FDI in general and benefit from it.</li> <li>- At the national level, special incentives could be one of the tools.</li> <li>- At the international level, the working group could examine, among other things, what can be learned from various instruments established in the context of the UNFCCC, such as the Clean Development Mechanism.</li> </ul>
8. Recognize the responsibilities of investors and address them in IIAs, in the interest of promoting desirable corporate conduct and balancing rights and responsibilities between investors and governments.	<ul style="list-style-type: none"> <li>- Various non-binding/mixed instruments address this issue and could be developed further (e.g. OECD Guidelines, OHCHR Guiding Principles on Business and Human Rights, ILO Tripartite Declaration).</li> <li>- Responsibility clauses could be included in IIAs that condition the availability of investor protections on compliance with applicable national or international instruments defining investor responsibilities.</li> </ul>	<ul style="list-style-type: none"> <li>- Constitute a working group of leading international investment experts, including practitioners and arbitrators, to propose how the purpose and contents of IIAs could best be updated.</li> <li>- Present the results to governments for their consideration in future investment rule making.</li> </ul>
<b>Developing an international investment support programme for sustainable development</b>		
9. Turn the Aid for Trade Initiative into an Aid for Investment and Trade Initiative.	<ul style="list-style-type: none"> <li>- Virtually all governments seek to attract FDI and benefit from it. But a number of governments, especially of the LDCs, have weak capabilities to compete successfully in the world FDI market.</li> <li>- The key premise is the importance of creating more favourable conditions for higher <i>sustainable</i> FDI flows to meet the investment needs of the future.</li> </ul>	<ul style="list-style-type: none"> <li>- Such an effort could be pursued in the short term through the Global Review on Aid for Trade. It would include WTO members and other international organizations.</li> <li>- The new initiative should cover investment fully, create an integrated platform for promoting sustainable FDI, improve national FDI regulatory frameworks, and strengthen investment promotion capabilities, especially in LDCs and other developing countries.</li> </ul>
10. Expand the Trade Facilitation Agreement to cover sustainable investment, making it an Investment and Trade Facilitation Agreement.	<p>Same as above.</p> <p>(This is a more ambitious medium-term option.)</p>	<ul style="list-style-type: none"> <li>- A subsidiary body of the Committee on Trade Facilitation (to be established in the WTO when the TFA enters into force) could provide the platform to consult on any matters related to the operation of what would effectively be a sustainable investment module within the TFA.</li> </ul>

Policy option	Current status and gap	How to get there
<b>11. Urge a multilateral organization to launch a Sustainable Investment Facilitation Understanding focusing on ways to encourage sustainable FDI flows to developing countries.</b>	Same as above. (This is a long-term option.)	<ul style="list-style-type: none"> <li>- Work on such an Understanding could be undertaken (in due course) in the WTO. It could also begin within another IGO with experience in international investment matters – e.g. UNCTAD, the World Bank, or the OECD (ILO, UNEP and OHCHR could also bring their expertise).</li> <li>- A group of the leading outward FDI countries could also launch such an initiative (which would be a plurilateral approach).</li> <li>- The impetus could come from the G20, which could mandate the initiation of work on the development of an Understanding.</li> </ul>
<b>12. Conduct detailed substantive work to flesh out what aspects of “investment facilitation” could be included in the above options.</b>	Same as above.	<ul style="list-style-type: none"> <li>- This could be done by the organizations mentioned above or by a credible NGO or by a balanced group of experts and practitioners.</li> <li>- A knowledge bank jointly organized by IGOs with a track record in the various aspects of international investment could be established, as a depository for information and experiences available to developing countries seeking to attract sustainable FDI.</li> </ul>
<b>Addressing the challenge of preventing, managing, and resolving disputes</b>		
<b>13. Establish investor-state conflict management mechanisms at the national level to help prevent, manage, and resolve disputes.</b>	<ul style="list-style-type: none"> <li>- Governments need to develop national investor-state conflict management mechanisms that allow governments and investors to address their grievances before they escalate into full-blown legal disputes.</li> <li>- Institutional infrastructure needs to be developed to engage in regular government-private sector dialogues and to monitor conflicts and resolve these.</li> </ul>	<ul style="list-style-type: none"> <li>- Institutions such as national investment ombudspersons and inter-ministerial committees that vet conflicts when they arise are helpful here.</li> <li>- The World Bank has begun to help countries to establish such conflict-management mechanisms, an effort that ought to be made available to as many countries as possible.</li> <li>- National investment promotion agencies could be assisted to conduct IIA impact assessments and to advise on the implementation of treaty commitments.</li> </ul>
<b>14. Provide assistance to low-income countries negotiating large-scale contracts.</b>	Same as above.	<ul style="list-style-type: none"> <li>- Support the creation of an investment negotiation support facility currently being considered by the G7 (with LDC backing), not only to arrive at well-negotiated contracts but also to reduce the likelihood that disputes arise. This initiative should come to fruition as soon as possible.</li> </ul>

Policy option	Current status and gap	How to get there
<p><b>15. Further institutionalize ISDS through the establishment of an appellate mechanism and/or a world investment court (e.g. through an ICSID II agreement).</b></p>	<p>- It is unavoidable that some disputes reach the international arbitral level. Given the centrality of the investor-state dispute-settlement (ISDS) mechanism to the investment regime, that mechanism has to be beyond reproach.</p> <p>- This is not only a technical matter, but also one that has implications for the very legitimacy of the international investment regime. A number of steps have already been taken to improve this mechanism, but more needs to be done.</p>	<p>- Several different arrangements are conceivable:</p> <p>a) Awards issued by the <i>ad hoc</i> panels currently used in IIA disputes could be appealed to <i>ad hoc</i> appellate bodies (the members of the appellate bodies could be chosen from a predetermined list of experts, preferably by an independent third party).</p> <p>b) The establishment of a single permanent and independent world investment court could be envisaged.</p> <p>c) An appellate mechanism for reviewing awards could be established in the framework of a treaty between two or more parties, to review decisions of <i>ad hoc</i> tribunals; other states would be invited to opt in, multilateralizing the appellate mechanism in this manner.</p> <p>-Since ICSID is the single most prominent dispute-settlement venue, one could think of a treaty updating the present Convention—an ICSID II. It would preserve enforceability, but update any features in the current rules that might require modernization. Such a new treaty could create a single world investment court (and appellate body) that would then be available to all governments that have signed and ratified the treaty.</p>
<p><b>16. Allow governments direct access to ISDS as claimants.</b></p>	<p>- There is the question of access to any dispute-settlement mechanism. In particular, if the contents of IIAs are expanded to include investor responsibilities, governments arguably should have direct access to the regime's dispute-settlement mechanism and not only by way of counter-claims.</p>	<p>- Embarking on the process of exploring how the current dispute-settlement mechanism could be improved would send a strong signal that governments recognize the need to develop a better mechanism.</p> <p>- Discussions of the range of issues relating to this matter are already underway in a number of governmental and non-governmental forums, ranging from the European Parliament to various academic conferences. These should be expedited. All interested stakeholders should be heard and all pertinent issues should be addressed.</p>
<p><b>17. Consider, long-term, turning ISDS into an investment dispute-settlement mechanism and opening it to other stakeholders.</b></p>	<p>- Following option 15, the question would also arise whether the dispute-settlement process should then be opened up further to other stakeholders too (this would be a profound, challenging, and very ambitious change).</p>	<p>Same as above.</p>

Policy option	Current status and gap	How to get there
<b>Establishing an Advisory Centre on International Investment Law</b>		
<p><b>18. Establish an independent Advisory Centre on International Investment Law (ACIIL).</b></p>	<ul style="list-style-type: none"> <li>- A strong signal demonstrating the will to enhance the legitimacy of the investment regime would be sent if the ability of vulnerable countries to defend themselves in disputes would be improved.</li> <li>- LDCs particularly do not generally have the human resources to defend themselves adequately, and many do not have the financial resources to hire the required expertise. This puts many countries in an asymmetric situation whenever a dispute arises.</li> <li>- An independent ACIIL would help to establish a level playing field by providing administrative and legal assistance to low-income country respondents.</li> </ul>	<ul style="list-style-type: none"> <li>- The process of clarifying the issues surrounding the creation of an Advisory Centre on International Investment Law should begin now.</li> <li>- Persuade a few governments concerned about the legitimacy of the international investment regime to assume a lead role in establishing such a Centre, supported by an NGO with a track record of work on the international trading system and drawing on the experience of IGOs.</li> <li>- The WTO Advisory Centre has done valuable work, contributing to enhancing the legitimacy of the international trading system. An Advisory Centre on International Investment Law (which would suitably complement the reform of the ISDS mechanism) could do the same thing for the international investment regime.</li> </ul>
<p><b>19. Create a small-claims court for SMEs and designate an International Investment Ombudsperson.</b></p>	<ul style="list-style-type: none"> <li>- Similar considerations as above apply to SMEs, as they typically do not have the expertise and resources to bring claims. They too require support. Costs and delays could become even more of an obstacle if an appeals mechanism were to be established.</li> </ul>	<ul style="list-style-type: none"> <li>- A small-claims settlement mechanism, with an expedited process, set deadlines and sole arbitrators, could be of help.</li> <li>- As a low-cost alternative dispute-settlement mechanism of potential value, an International Investment Ombudsperson could be designated, cooperating with an <i>ad hoc</i> ombudsperson in a respondent state.</li> </ul>
<b>Negotiating a multilateral/plurilateral framework on investment</b>		
<p><b>20. Initiate an exploratory process towards negotiating a comprehensive universal framework on international investment, preferably a multilateral framework on investment, possibly starting with a plurilateral framework on investment that would be open for future accessions by other states.</b></p>	<ul style="list-style-type: none"> <li>- The convergence of policy interests that has been underway between home and host countries with the growth of outward FDI from emerging markets could facilitate reaching such an objective.</li> <li>- Governments continue to show a great willingness to make rules on international investment. This is reflected in the negotiation of bilateral investment treaties between key countries (e.g. US-China BIT), and in the negotiation of mega-regional agreements with investment chapters (e.g. TPP).</li> <li>- These negotiations represent opportunities to shape the investment regime by narrowing the substantive and procedural investment law differences among the principal FDI host and home countries.</li> </ul>	<ul style="list-style-type: none"> <li>- A universal framework would have to start from the need to promote sustainable FDI for sustainable development. The most comprehensive recent effort in this respect is the UNCTAD Investment Policy Framework for Sustainable Development.</li> <li>- The WTO offers the best platform for trade and investment regimes to be combined and consolidated, as a unified system providing systematic legal and institutional support for the future growth of GVCs, turning that organization into a World Investment and Trade Organization. The WTO Working Group on the Relationship between Trade and Investment could be reactivated or a new working group could be established.</li> </ul>

Policy option	Current status and gap	How to get there
	<ul style="list-style-type: none"> <li>- The negotiation of a multilateral instrument (especially a high-standards one) would face major challenges in light of the unsuccessful efforts of the past and the wide range of views surrounding IIAs.</li> <li>- The July 2015 decision by the Third International Conference on Financing for Development has mandated UNCTAD to work with member states to improve IIAs.</li> </ul>	<ul style="list-style-type: none"> <li>- Another alternative is to build on existing agreements, especially the GATS, to cover other types of investment and obligations.</li> <li>- There might also be the possibility that the international investment court and appellate mechanism sought by the European Commission could become a stepping stone towards a permanent multilateral system for investment disputes, which, in turn, could become the nucleus around which a universal framework could be built.</li> <li>- If a multilateral framework is out of reach at this time, a plurilateral framework could serve as a first step. It could be an agreement negotiated by interested parties that would be open for future accessions. It could also build on recent bilateral and mega-regional agreements (e.g. Pacific Rim) in a process of sequential multilateralization.</li> <li>- The G20 is a potential forum to launch the exploratory process.</li> </ul>

**Launching an (accompanying) informal and inclusive consensus-building process**

<p><b>21. Encourage a credible NGO to launch and organize an informal process to encourage a free and open discussion of all the issues involved.</b></p>	<ul style="list-style-type: none"> <li>- Any systematic process to improve the investment regime needs to be government-led and -owned.</li> <li>- However, considering the range of stakeholders involved in international investment matters, it would be advisable to launch an (accompanying) informal but inclusive confidence-, consensus- and bridge-building process on how the international investment law and policy regime can best be enhanced.</li> </ul>	<ul style="list-style-type: none"> <li>- A trusted institution, perhaps with the support of a few countries and in cooperation with an international consortium of academic institutions, should organize the process outside an intergovernmental setting.</li> <li>- It should identify systematically any weaknesses of the current regime and advance concrete proposals on how to deal with them.</li> <li>- It should be inclusive and involve the principal stakeholders to ensure that all issues are discussed and all key interests are taken into account.</li> <li>- The outcome could be a draft agreement that could be made available to governments to use as they see fit.</li> </ul>
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**Additional recommendation**

<p><b>Provide better data</b></p>	<ul style="list-style-type: none"> <li>- Countries do not necessarily follow the reporting guidelines provided by IMF, UNCTAD and OECD.</li> <li>- Implementing these guidelines would correct major distortions in international investment statistics.</li> </ul>	<ul style="list-style-type: none"> <li>- Encourage all countries to report FDI flows with and without special-purpose-entity transactions and on the basis of the location of the ultimate parent firm, to provide better data for the evaluation of the impact of FDI.</li> <li>- Technical assistance programmes undertaken by IGOs could help.</li> </ul>
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## International Centre for Trade and Sustainable Development

The International Centre for Trade and Sustainable Development (ICTSD) is an independent think-and-do-tank, engaged in the provision of information, research and analysis, and policy and multistakeholder dialogue, as a not-for-profit organisation based in Geneva, Switzerland.

Established in 1996, ICTSD's mission is to ensure that trade and investment policy and frameworks advance sustainable development in the global economy.



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IMPROVING THE STATE  
OF THE WORLD

# Enhancing Coherence and Inclusiveness in the Global Trading System in the Era of Regionalism

Policy Options Paper



 The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND  
INVESTMENT SYSTEM FOR SUSTAINABLE DEVELOPMENT

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# Enhancing Coherence and Inclusiveness in the Global Trading System in an Era of Regionalism

Kati Suominen

on behalf of the E15 Expert Group on Regional Trade Agreements and Plurilateral Approaches

January 2016

\* Paper prepared with collaboration by Antoni Esteve de Oda, Manager of the Integration and Trade Sector of the Inter-American Development Bank, co-convenor of the E15 Expert Group.

## Note

The policy options presented in this synthesis are the result of a collective process involving all members of the E15 Expert Group on Regional Trade Agreements and Plurilateral Approaches. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15 Initiative and authored by group members. Kati Suominen was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15 Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15 Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15 Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15 Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15 Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15 Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15 Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15 Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15 Initiative:  
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# Abstract

Over the past two decades, regional trade agreements (RTAs) have proliferated alongside the WTO system, involving a wide variety of agreements. In the absence of significant progress on the multilateral front, they have served as focal points of inter-state cooperation, as well as incubators and testing grounds for new trade rules. Over time, these agreements have evolved and many now contain disciplines that are wider in scope, deeper in nature, and significantly more sophisticated than the multilateral trading system. There is also a new trend towards mega-regional initiatives of potentially systemic impact, as well as plurilateral negotiations in important functional areas such as services. These developments have opened opportunities but also given rise to challenges, particularly regarding issues of coherence and inclusiveness, in this emerging global trade and investment architecture. The present paper examines the implications of this new era

of regionalism and offers recommendations on how the system of RTAs can best be leveraged to advance trade and development. Seven policy options are grouped into three work areas: furthering the potential benefits of RTA integration with third parties; using plurilateral approaches as a means to multilateralize RTAs; and, pooling resources to advance the effective implementation of RTAs and new idea-generation. The analytical and practical perspective on which the options are framed is that WTO members need a new 21st century approach to RTAs; one that harnesses the opportunities created by RTAs to deepen and broaden global economic integration, and one that helps ensure that all WTO members, including the many developing countries that are outsiders to ongoing mega-regional and plurilateral initiatives, can benefit from the global trade and investment system. The paper concludes by identifying factors that will influence future patterns of regional economic integration.

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## Abbreviations

ADB	Asian Development Bank
CRTA	Committee on Regional Trade Agreements
EU	European Union
FTA	free trade agreement
FTAAP	Free Trade Area of the Asia-Pacific
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
IDB	Inter-American Development Bank
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
RCEP	Regional Comprehensive Economic Partnership
RoO	rules of origin
RTA	regional trade agreement
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
US	United States
WTO	World Trade Organization

# Executive Summary

As the Doha Round of multilateral trade negotiations has stalled in recent years, regional trade agreements (RTAs) and plurilateral approaches to economic integration have commanded the principal focus in the trade policy strategies of many countries, including many of the largest economies. These include new mega-regional agreements, such as the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), and the Regional Comprehensive Economic Partnership (RCEP). Meanwhile, several WTO members have moved to form plurilateral agreements in certain functional areas, such as the Trade in Services Agreement (TiSA). This has opened new opportunities but also given rise to challenges, particularly regarding issues of coherence and inclusiveness, in this emerging global trade and investment architecture.

As a contribution to the debate, the E15 Expert Group on Regional Trade Agreements and Plurilateral Approaches, convened by ICTSD and the World Economic Forum in partnership with the Inter-American Development Bank (IDB), has examined the implications of recent developments in RTAs, including their broader and deeper policy coverage, for the global trading system. The outcome of this expert dialogue process is a set of recommendations presented in this paper on how the evolving system of RTAs can best be leveraged to advance the WTO's mission "to open trade for the benefit of all."

The policy options are grouped into three work areas: furthering the potential benefits of RTA integration with third parties; using plurilateral approaches as a means to multilateralize RTAs; and, pooling resources to advance the effective implementation of RTAs as well as new idea-generation.

## Background

Following a comprehensive overview of the historical interaction between the WTO and RTAs, and an overview of recent developments in regional integration, the paper identifies five areas on which WTO members should focus on for a new 21<sup>st</sup> century approach to RTAs.

The underlying perspective is that this approach should harness the opportunities created by RTAs to deepen and broaden global economic integration, and help ensure that all WTO members, including the many developing countries that are outsiders to ongoing mega-regional and plurilateral initiatives, can benefit from the evolving trade architecture.

First, questions about the impact of RTA disciplines on outsiders have not been systematically addressed or acted on when it would make the biggest difference: during RTA negotiations. Second, easing some of the transaction costs and complexity of overlapping RTAs could yield significant economic gains, including for smaller economies. Third, plurilateral agreements could be the right vehicles to enable a greater number of countries to sign onto rules incubated in RTAs, however, it is unclear which plurilateral agreements should be negotiated or how these negotiations and subsequent accessions should optimally be structured so as to potentially enable all WTO members to benefit from them. Fourth, the implementation of RTAs by policy-makers and the application of RTAs by firms are often suboptimal, as is the monitoring of their functioning, in part due to the dispersion of knowledge and resources on RTAs. Fifth, the recent mega-regional trade negotiations have raised new concerns among the general public about RTAs, and in particular regarding a lack of transparency.

## Policy Options

There are three ways in which countries forging agreements, especially in the context of mega-regional arrangements, could consciously cultivate open regionalism, advance synergies among RTAs, and broaden the potential benefits from integration with third parties. First, countries negotiating agreements could be more deliberate about including in their agreements standards that outsiders will voluntarily adopt, and on creating markets that are more easily contested by non-parties. The *ex ante* impact assessment of agreements on outsiders should be furthered. Second, in addition to improving RTA disciplines, there are several ways in which RTA members can expand trade with outsiders. These include advancing trade facilitation, customs modernization, and regional infrastructure among RTA members. Third, there are opportunities to create greater coherence among RTAs, not least by unraveling the spaghetti bowl of rules of origin and allowing for diagonal cumulation across agreements.

A critical challenge that lies ahead is how the WTO and RTA systems can be made more synergistic and mutually reinforcing. Plurilateral agreements—broad-based agreements among subsets of the WTO membership—offer a path forward. They may also provide a means to pioneer entirely new rules and commitments in an otherwise clogged system. However, for plurilaterals to be truly effective and integrative, three reforms are needed. First, negotiating modalities in the WTO need to change. The WTO membership should agree on a shift from the current unanimity rule and single undertaking principle to enable

faster deals among a critical mass of members. Second, there are no common guidelines for negotiating plurilaterals. Countries should negotiate a multilateral code of conduct to govern the subsequent negotiation of plurilaterals in the context of formal WTO processes. Such a code could outline principles that would allay existing concerns on plurilaterals and provide members with procedural guidance as well as *ex ante* rules on future rights and obligations. Third, the WTO could create a “linking” mechanism whereby the commitments of new plurilaterals can be extended on a most-favoured-nation basis to third parties willing to adhere to these commitments, thus gradually multilateralizing the agreements.

Although RTAs are emerging as the centre of gravity in global trade and investment, there is no institution or body, to date, which methodically brings together all relevant information on RTAs around the world. To bridge this gap, the Inter-American Development Bank, in collaboration with the Asian Development Bank and ICTSD, is developing an RTA Exchange. The Exchange is conceived to further dialogue and thought on ways to make RTAs better work for trade and development. It will act as a global venue for information-sharing, idea-generation, e-learning, and capacity-building on practical and strategic aspects related to RTAs and the multilateral trading system among a broad and diverse set of stakeholders.

## Next Steps

The seven policy options put forward by the Expert Group can all conceivably be considered for implementation over a short- to medium-term time horizon. While these recommendations for reform and dialogue are being pursued, longer-term thinking and engagement should start on the future of RTAs, particularly in light of the changing geography of trade and investment as well as new market drivers that will influence the pattern of economic integration over the coming years.

# 1. Introduction

As multilateral trade talks have stalled over the past several years, regional trade agreements (RTAs) have taken centre stage in the trade policy strategies of many countries. As of August 2015, 406 RTAs have been notified to the World Trade Organization (WTO) and several more are under negotiation. All WTO members are parties to at least one RTA. Markedly, today's mega-regional trade agreements, the Trans-Pacific Partnership (TPP), which is awaiting ratification, and the Transatlantic Trade and Investment Partnership (TTIP), which is under negotiation, will once concluded regulate trade among countries from which originate over 40% of world commerce. A new leading trader, China, is forging agreements in Asia, most notably the Regional Comprehensive Economic Partnership (RCEP). Several WTO members have also moved to form agreements in certain functional areas among "coalitions of the willing," such as the Trade in Services Agreement (TiSA) now under negotiation among 23 WTO members accounting for 70% of world trade in services. Some large RTAs, such as the Free Trade Area of the Asia-Pacific (FTAAP), are also actively being planned. In the trade policy work of most countries and companies, RTAs and plurilateral agreements now command the principal focus.

Regional trade agreements have in many ways been beneficial for countries around the world. They have enabled countries to open access to new markets and emerge as incubators of new trade-related rules in such areas as services trade, investment regulations, intellectual property rights, e-commerce, customs procedures and trade facilitation, and labour and environmental standards. RTAs have also propelled export-oriented, efficiency-seeking investment, fuelled the formation of value chains, and paved the way for cooperation among members in trade-related areas, such as infrastructure integration. In addition, RTAs have been found to help relax the political economy constraints to further trade liberalization in participating nations and cement national economic policies in areas such as competition policy.

The multilateral trading system and RTAs have co-existed for decades, albeit somewhat uneasily. From the beginning, the GATT system allowed member countries to grant each other preferential treatment under free trade areas or customs unions, as long as certain conditions were met. The proliferation of RTAs in the past two decades has created a sense of urgency among WTO members to examine whether RTAs are discriminatory towards outsiders, how exactly the various GATT regulations on preferential treatment should be interpreted, and whether their scope should be broadened. These concerns have grown as each WTO member has found itself an outsider

to an ever-growing number of RTAs. In the Doha Round, WTO members elevated RTAs to a "systemic issue," or one that affects the entire world trading system and needs to be addressed as such.

Given that RTAs are here to stay, it is time for policy-makers and trade experts to move beyond the traditional question of whether RTAs undermine or buttress the multilateral trading system. A much more fruitful discussion in today's world is how the system of RTAs can be best leveraged to enable companies of all sizes around the world to seamlessly export, import, invest across borders, and operate in global markets; consumers in every economy to access a wider variety of products and services at low cost; and all economies—particularly the many small and less developed economies that are not part of mega-regional agreements—to benefit fully from today's global trade architecture. In other words, it is time to analyse how the system of RTAs can best advance the WTO's mission "to open trade for the benefit of all."

For these objectives to be met, a number of specific issues and problems need to be addressed. Indeed, while RTAs have freed trade and deepened economic integration around the world, they have also created some challenges. Among these are concerns about preference erosion affecting especially developing economies, challenges faced by smaller businesses to meet demanding RTA standards and rules of origin, and the "spaghetti bowl" problem—the high complexity of overlapping rules and agreements facing companies that operate global supply chains across multiple RTAs.

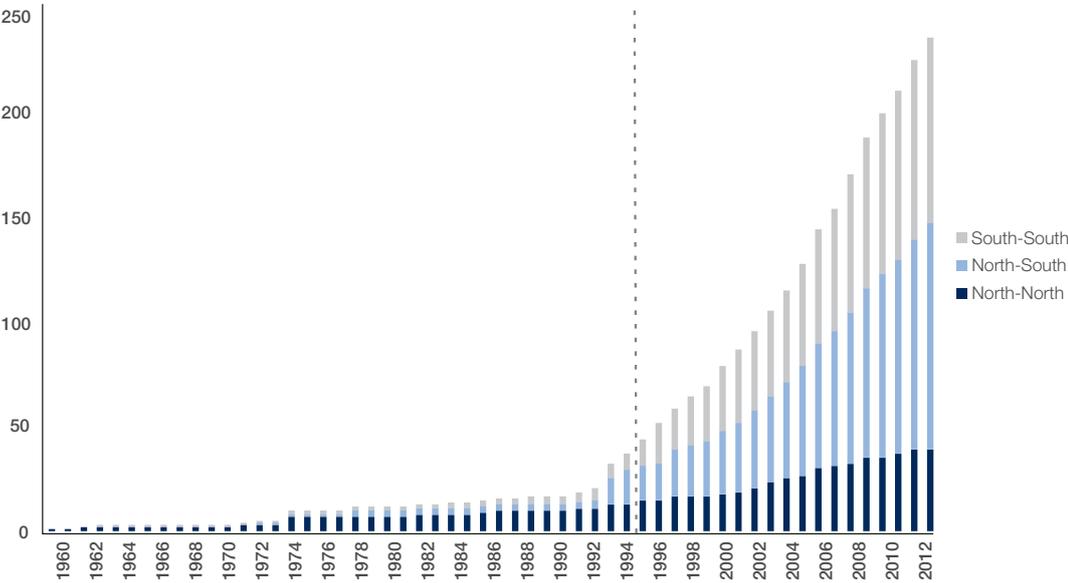
The purpose of this paper is to put forward policy options to address these and other challenges in today's global trade regime. The paper draws on the discussions and think pieces of the E15 Expert Group on Regional Trade Agreements and Plurilateral Approaches, convened by ICTSD and the World Economic Forum and supported by the Inter-American Development Bank (IDB). The next section reviews the proliferation of RTAs and the policy challenges that this emerging global trade architecture presents. Against this backdrop, the third section then lays out key policy options, as developed by the E15 Expert Group. The policy options are grouped under three categories: furthering the potential benefits of RTA integration with third parties; using plurilateral approaches as a means to multilateralize RTAs; and, promoting coherence among RTAs and the multilateral trading system. Section four concludes with a discussion on future patterns in economic integration in light of the changing geography of trade and new market drivers.

# 2. New Challenges and Opportunities in the RTA System

Regional trade agreements have proliferated around the world in the past decades alongside the GATT, the General Agreement on Trade in Services (GATS), and the WTO system. This proliferation has refashioned the geography of trade integration. In the past, perhaps with the exception of some European agreements, most RTAs were North-North agreements negotiated among advanced economies. Over the past two decades, however, RTAs have grown to include a wide variety of North-South and South-South agreements (Figure 1). Meanwhile, the share of world trade

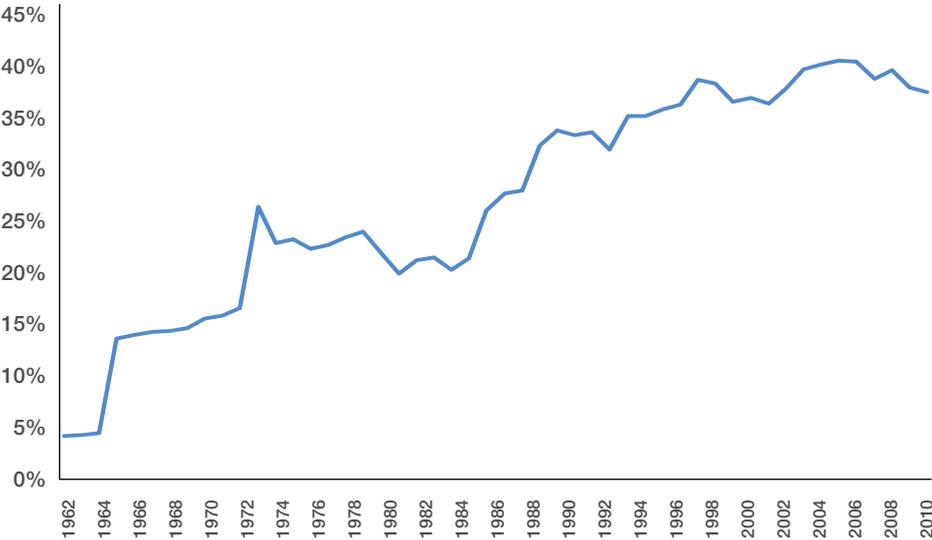
that flows among pairs of countries that share an RTA had grown to nearly 40% by 2012 (Figure 2). The make-up of RTAs has also changed. Following the conclusion in 1994 of the North American Free Trade Agreement (NAFTA)—which included extensive binding commitments across issue areas such as market access for goods, investment, trade in services, intellectual property rights, and competition policy—the number of such deep agreements has grown significantly (Figure 3).

**Figure 1:** Partners in RTAs Globally in 1960-2012, by Geography



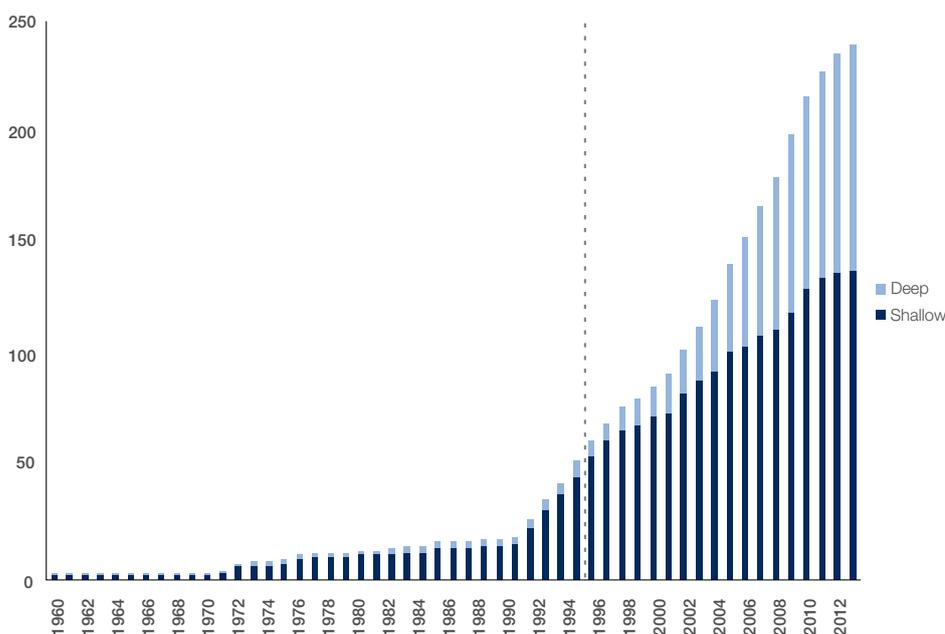
Source: IDB-INT based on WTO RTA database.

**Figure 2:** Share of World Trade Covered by RTAs, 1960-2010



Source: IDB data

**Figure 2: Regional Trade Agreements in Effect in 1960-2010, by Depth of Commitments**



Source: OECD Secretariat based on WTO RTA database and other sources.

For several WTO members and active trading nations, such as Chile, Peru, and Mexico in Latin America, or Korea and Singapore in Asia, regional and bilateral agreements are now the preferred and most important means to conduct economic exchange with trading partners. With the TPP, the TTIP, and the RCEP, this is becoming true for the world's largest traders: the United States, the EU, Japan, and China.

## 2.1. Interaction Between the WTO and RTAs

GATT and WTO members have been forming RTAs while concluding seven multilateral trade rounds, establishing the WTO in 1994, and, since 2001, negotiating the Doha Round. There are countless theories to explain this pattern—some focus on interest group pressures by exporter lobbies, others on developing country interests in using RTAs as a means to attract foreign direct investment, and still others on geopolitical considerations.<sup>1</sup>

One explanation for the wildfire-like spread of RTAs is the lack of substantial progress in the WTO system since its establishment. Members have struggled under the WTO's standard negotiating modality, the single undertaking principle, where nothing is agreed until everyone agrees to everything. Also complicating multilateral talks and the Doha Round, in particular, are the changing political economy dynamics among WTO members, spawned by the rise of large emerging powers whose interests differ quite significantly from those of the main advanced economies. RTAs offer a way out of the deadlock at the multilateral level.

They enable countries to expand market access, attract foreign direct investment, and craft new rules that respond to emerging needs in the market. The RTA system itself encourages the formation of new agreements: as more and more RTAs are forged, outsiders face an urgent need to form agreements of their own so as not to miss out on the benefits RTAs confer to others.

The traditional question concerning RTAs is whether they help or hinder multilateralism and most-favoured-nation (MFN) treatment. This is an important question both from a formal, legal point of view and from an actual, economic point of view. Incompatibilities between RTAs and the multilateral trading system could be interpreted as violations of international trade law and could distort global trade flows, production patterns, and economic growth. It is a question that has troubled WTO members for decades.

The 1948 GATT allows member countries to grant each other preferential treatment under free trade agreements (FTAs) or customs unions as long as certain conditions are met. These conditions were defined mainly in GATT Article XXIV, but also in the GATS, other WTO agreements, and the so-called Enabling Clause, which exempts developing countries from MFN obligations in RTAs they form with each other. GATT Article XXIV stipulates that members notify their RTAs to what is now the WTO and that RTAs liberalize “substantially all trade” among members “in reasonable length of time” and not introduce new “restrictive rules on commerce.”<sup>2</sup> The article also demands open regionalism—i.e. that RTA members do not raise barriers to third parties.

<sup>1</sup> The literature is huge and only some representative studies are highlighted here. For more exhaustive literature reviews, see, Winters (1996); Baldwin (2006); Bhagwati (2008); Mansfield (1998); World Bank (2000); Schiff and Winters (2003); Esteveadoral and Suominen (2009).

<sup>2</sup> For the purposes of Article XXIV, a customs union is understood as “the substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and, (ii) ... substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.” A free trade area is “a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.”

Concerns that RTAs are protectionist instruments have, since the early 1980s, prompted three major efforts in the GATT/WTO system to regulate them.<sup>3</sup> However, WTO members have practically never debated or agreed whether any one RTA breaches multilateral trade rules, let alone the revised Article XXIV: multilateral, top-down regulation of RTAs has not worked. This is hardly surprising. WTO members are protective of their agreements, and they are unlikely to agree to any multilateral rules that might curb their ability to negotiate bilateral and plurilateral agreements or force them to modify their existing agreements. Moreover, since practically all WTO members participate in at least one RTA, all are reluctant to challenge the RTAs of other members as discriminatory (let alone take another member to the dispute settlement body), as the challenger could be next called out. As such, the dispute settlement body has dealt with RTAs on only a handful of occasions.<sup>4</sup> Furthermore, the resources available to the WTO Secretariat to perform in-depth analyses on RTAs are limited; in addition, political sensitivities have curbed the ambition of these studies. WTO working papers and the World Trade Report have provided more detailed analyses on RTAs, but these are intended to provide information about RTAs rather than to pinpoint violations.

Nevertheless, WTO members have been concerned about the systemic implications of RTAs. In 1996, the WTO General Council established the Committee on Regional Trade Agreements (CRTA) to examine individual RTAs and consider their systemic, cross-cutting implications for the multilateral trading system. Members that were eager to engage in the debate included Australia, Hong Kong, India, Japan, Korea, New Zealand, and Pakistan, while the EU and the US, both of which were increasingly engaged in

negotiating RTAs, were reluctant. The Committee remained dormant, not issuing any examinations in the 1996–2001 period.<sup>5</sup>

Have WTO members complied with Article XXIV? The answer is negative in the sense that numerous RTAs among developing countries are exempted. But it also depends on how exactly the multilateral disciplines governing RTAs are interpreted.<sup>6</sup> WTO members' interpretations of the Article vary widely (Estevadeordal and Suominen 2009). For example, "substantially all trade" has at least two different interpretations: a quantitative approach, geared towards a statistical benchmark, such as a percentage of trade between RTA parties, commonly suggested as 90%, 85%, or 80%; and, a qualitative approach, stipulating that no sector (or at least no major sector) should be kept from liberalization, with definitions of "sector" varying widely.

Empirically, most agreements do meet some of these most common interpretations of "substantially all trade" and "reasonable length of time"—liberalization of 90% of tariff lines and about the same amount of trade by year ten into the agreement (Estevadeordal and Suominen 2009). However, there are also a number of outlier RTAs (in general among developing countries) that do not want to single out product categories (particularly sensitive sectors, such as agriculture, textile and apparel, and footwear) that have prolonged tariff phase-outs and/or non-tariff barriers.

There also is no clear agreement on what constitutes "other restrictive regulations of commerce." RTAs carry several rules that can qualify the extent of market access that tariff liberalization provides, such as tariff-rate quotas; special safeguards; anti-dumping regulations; non-tariff measures;

<sup>3</sup> As early as 1983, the GATT Director-General created an independent group of seven eminent persons to study and report on the problems facing the international trading system. The Leutwiler Report, issued in March 1985, concluded that multilateral "rules permitting customs unions and free-trade areas have been distorted and abused" and that "the exceptions and ambiguities which have thus been permitted have seriously weakened the trade rules, and make it very difficult to resolve dispute to which Article XXIV is relevant." During the 1986–1994 Uruguay Round, a group of countries that included Australia, India, Japan, Korea and New Zealand—nations that at the time had not set out to form numerous RTAs but did worry about the discriminatory impact of emerging agreements—called for toughening the language of Article XXIV (WTO 2011). India proposed reviewing the requirement that duties and other restrictive regulations be eliminated on "substantially all trade" between the RTA partners (Croome 1995). Japan called for improving the consultations before and after preferential agreements were reached and for improved procedures for examination of such agreements, proposing the establishment of special procedures separate from the GATT dispute settlement system aimed at discussing compensation for damages to outsiders to RTAs (Croome 1995). The members that opposed Japan's proposal suggested that RTAs be analysed under the newly-created Trade Policy Review Mechanism, which assesses WTO members' compliance with their multilateral trade commitments. The grievances did result in the Understanding on Interpretation of Article XXIV, which helped clarify "reasonable length of time" as 10 years into an RTA's lifespan and fine-tuned paragraph 5 to call for multilateral assessments of "the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union." The Understanding also establishes procedures in cases where non-members to a customs union should be compensated if the common external tariff applied by the customs union is above the level of the tariff applied by any of the members prior to its forming. It also posits that concerns related to Article XXIV could be submitted to dispute settlement (Croome 1995). Despite initial opposition by the EU, India, and Yugoslavia, the Understanding was adopted and became part of the Uruguay Round agreements (WTO 2011). A further important outcome of the Uruguay Round was the inclusion of a provision on the regulation of regional and bilateral agreements on trade in services in the GATS.

<sup>4</sup> The main one is Turkey–Textiles, the WTO Appellate Body held that the burden of establishing that an RTA meets the requirements of Article XXIV falls on the respondent WTO member if it invokes the RTA to justify a discriminatory measure.

<sup>5</sup> One of the reasons was that WTO members were reluctant to provide information or agree to conclusions that could later be used or interpreted by the WTO's dispute settlement panel. The process was also stifled by the disagreements over the terminology of Article XXIV, and the lack of specific multilateral language on such provisions as preferential rules of origin. Also, views on whether the CRTA or the dispute settlement body should deal with RTAs remain divided. Some hold that the examination of the consistency of RTAs ought to be reserved solely to the CRTA. One notion is that GATT and WTO rules applying to RTAs are of less relevance today in the light of the fact that trade diversion is reduced as a result of multilateral tariff reductions. The empirical evidence on positive welfare effects of RTAs, and that they are different from WTO agreements, lie in that they cover more trade-related disciplines (Mavroidis 2010). As such, the Transparency Mechanism should become the de jure new forum to discuss RTAs within the multilateral trading system.

<sup>6</sup> Indeed, the very design of Article XXIV was not immune to politics. It was sponsored in the 1940s by the US, a staunch advocate of multilateralism and non-discrimination, as a means to address customs unions, but it was extended to allow for the formation of FTAs to accommodate the imminent US-Canada FTA that was under secret negotiations but failed to materialize (Chase 2006).

and, rules of origin (RoO). Such disciplines are often put in place for political reasons, as governments may be more willing to engage in deep tariff liberalization in RTAs when defensive instruments are also available. However, the distortionary impact of these instruments can be significant and accentuate over time, as such rules tend to remain in place even after preferential tariffs have been phased out. For example, by tying final goods producers to using intra-RTA sourcing even if it is inefficient, stringent RoO can at the extreme augment intra-RTA production costs to the point where compliance costs exceed the benefits that RTA tariff preferences confer.<sup>7</sup>

Compliance of RTA members with the prohibition against raising barriers to third parties has also been disputed. Indeed, economists have long engaged in a contentious debate on whether RTAs are “building blocks” or “stumbling blocks” to multilateral trade liberalization. The building block camp argues that RTAs fuel the liberalizing logic of the multilateral system, help advance global trade talks, and serve as laboratories for new trade rules that could eventually be multilateralized. The stumbling block camp maintains that RTAs are discriminatory instruments that lead to trade diversion and deviate governments’ attention from multilateral trade talks.

While both views find support in the empirical literature, the available evidence generally supports the building block thesis, with the exception of some sectors with limited liberalization and/or complex RoO, and especially some South-South RTAs where members fail to commit to open regionalism and liberalize trade with outsiders. The concern that RTAs discriminate against outsiders has also been diluted as multilateral, regional, and unilateral trade liberalization has progressed over recent decades.

In addition, for every argument against RTAs there are several in their favour. For example, while RTAs have been blamed for sapping energy from the multilateral trading system, they have helped save the global trading system in times of crisis. RTAs have emerged as incubators of new trade and trade-related rules in such areas as services trade, investment regulations, customs procedures and trade facilitation, environmental norms, intellectual property rights, and e-commerce. In many of these areas, RTAs are unquestionably more advanced and sophisticated than the multilateral trading system, helping member countries test drive new rules matching today’s market realities.

RTAs have also been found to help generate goodwill and greater economic interaction among members, which can be conducive to deeper integration and the pooling of resources in other policy areas, such as infrastructure development, or—as is the case especially in the Americas—in the harmonization of product standards (e.g. NAFTA) or integrating national export promotion efforts and stock markets (e.g. the Pacific Alliance). And much like multilateral trade liberalization, RTAs have also been found to impart benefits beyond traditional analyses on gains from trade, such as propelling export-oriented, efficiency-seeking investment flows among members, and helping to relax the political economy constraints to trade liberalization by aggregating national pro-trade forces in the participating nations, as well as cementing political and strategic ties among the member economies.

## 2.2. Key Challenges to Address in the RTA system

WTO members need a new 21st century approach to RTAs; one that harnesses the many opportunities created by RTAs to deepen and broaden global economic integration and one that helps ensure that all WTO members, including the many developing countries that are outsiders to ongoing mega-regional and plurilateral initiatives, can benefit from the evolving trade architecture. In practice, this most immediately means that resources and attention should be geared towards addressing the main unresolved challenges in the system of RTAs and perfecting what is already in place. The five areas outlined below should be the focus of such an approach.

### 2.2.1. Lack of clarity on the impact of RTA disciplines during negotiations

It is perfectly reasonable for two or more RTA members to forge rules that are tailored to their distinctive needs and political economy circumstances. The more complex question is the impact of these rules after the RTA is in place, especially vis-à-vis third parties—for example, whether they encompass standards that outsiders find favourable and voluntarily adopt, whether such rules are easy for developing economies to adopt, and whether they create markets that are easily contested by outsiders. This is a particularly pressing issue in mega-regionals where the leading trading powers set preferred rules that will be *de facto* templates for global standards—rules that outsiders will be induced to adopt so as not to remain at a disadvantage.

Evidence thus far seems to indicate that the trade effects of various RTA rules on third parties are more positive than negative. However, it is also well known that stringent rules of origin tend to disincentivize the use of cheaper inputs from outsiders to RTAs. Estevadeordal et al. (2013) estimate that, on average, countries source 15% more of their foreign value added from members of the same RTA than

<sup>7</sup> As such, demanding RoO are akin to a tariff on the intermediate product levied by the country importing the final good (Falvey and Reed 2000; Lloyd 2001). But, whether specific RoO are actually restrictive depends on the availability of inputs in the RTA region and the ex-ante production patterns.

from non-members. This concern is perhaps accentuated in the context of mega-regional agreements, as these agreements, which combined account for 49 economies, do not include most of the countries that stand to gain from accessing regional and global supply chains—smaller developing economies. Yet, questions about the impact of RTA disciplines on outsiders have not been systematically addressed or acted on when it would make the biggest difference: during RTA negotiations.

### 2.2.2. Complexity and transaction costs in the RTA system

Rather than centring production activities in a few locations, companies today tend to segment and spread production over an international network of sites. As a result, a growing share of global trade consists of intermediate goods shipped from one country to another, and many household items from cars to computers contain parts and labour from multiple geographical origins. The explosion of intermediate trade has been particularly striking in East and Southeast Asia. While RTAs are designed to lower the costs of cross-border business and global distribution networks, the spaghetti bowl of multiple overlapping RTAs has created transaction costs to companies that operate global supply chains. Furthermore, small business exporters seeking to trade across many different markets, each with its own RTA, are mired in a maze of rules.

Even though there are “RTA families” where different RTAs have rather similar rules (such as the respective trade agreements of the EU and the US), the proliferation of RTAs has compounded the spaghetti bowl problem. Studies by the Inter-American Development Bank (IDB) and Asian Development Bank (ADB) indicate that some 60–80% of large companies in diverse countries such as Peru, Singapore, Thailand, and Mexico would much prefer a single set of rules of origin to the numerous RoO regimes included in the RTAs signed by their respective governments. This complexity is also troublesome for customs officials in charge of verifying RoO in countries with multiple agreements, such as Chile, Mexico, Singapore, Thailand, the United States, and Vietnam. Easing some of these transaction costs could yield major economic gains, particularly for smaller economies.

### 2.2.3. Lack of clarity on best practices for plurilaterals

Regional trade agreements offer a vast reservoir of tested and tried rules that can help advance multilateral rule-making in critical areas. However, to date, many RTA disciplines have not been multilateralized, and, typically, they extend only to RTA members. They are also not covered by the WTO’s dispute settlement system. Expanding the number of countries that apply rules negotiated and applied in the major RTAs would most likely yield new efficiencies and increase world trade. Plurilateral agreements among large coalitions of the willing can be the right vehicles to enable a greater number of countries to sign onto rules incubated in RTAs. However, it is not yet clear which plurilaterals should be negotiated or how plurilateral talks

and subsequent accessions should optimally be structured so as to enable all WTO members to potentially benefit from them.

### 2.2.4. Gaps in the implementation, application, and real-time monitoring of RTAs

The implementation of RTAs by policy-makers and the application of RTAs by firms are still suboptimal, as is the monitoring of their functioning. The reasons behind these challenges include: lack of capacity and resources, especially among developing country policy-makers, to learn about best practices and policy innovations for negotiating and implementing RTAs; lack of real-time solutions to problems that companies face when applying RTAs; and, difficulties among policy-makers and business leaders to quickly identify the right sources to obtain data and get answers to specific questions related to RTAs.

All of these gaps can be bridged: the resources exist. After all, the RTA spree of the past decades has created a massive amount of rules, practical experiences, data, and debate on RTAs. Yet, these resources are dispersed across a variety of fora around the world, such as international organizations, multilateral and regional development banks, business associations, and regional organizations. Many useful experiences and lessons learned among experts and former negotiators remain altogether uncodified and untapped. This wealth of experiences and resources has yet to be purposefully brought together to advance the implementation, application, and monitoring of RTAs: there is no transmission mechanism. In addition, information and expertise is yet to be organized so as to systematically spark ideas and fresh thinking among experts around the world on the ways in which the RTA system could be improved. A number of policy entrepreneurs and intrepid analysts have brought some of this dispersed data and collective wisdom together, but such efforts, unless conducted at scale and on a sustainable basis, are of limited impact.

### 2.2.5. Pressures for greater transparency in RTA negotiations

The recent mega-regional trade negotiations have raised new concerns among the general public about RTAs and in particular with regard transparency. While RTA negotiations require a certain degree of confidentiality, the lack of transparency during the ratification process risks becoming the main focus and could derail approval.

# 3. Policy Options for System Coherence and Inclusiveness

There are several possible ways in which the challenges outlined in the previous section can be overcome to take fuller advantage of RTAs for global trade and development. This section offers a number of policy options that seek to act on the following question: how can RTAs best be used to broaden the gains from trade integration?

Encouragingly, the international debate is shifting in the right direction: moving away from a narrow focus on RTA trade effects to measures that strive to forge greater efficiencies and synergies across the many RTAs. The policy options presented below are grouped in three areas of work aimed at making more of RTAs: furthering open regionalism in RTAs, particularly in agreements under negotiation, and advancing synergies among the many RTAs; using plurilateral negotiations to multilateralize RTAs; and pooling resources across stakeholders in a purposeful manner to advance the effective implementation and application of RTAs as well as new idea-generation on RTAs.

## 3.1. Furthering the Benefits of RTA Integration with Third Parties

As indicated, the multilateral system and existing RTAs will be influenced by ongoing and future mega-regional agreements. New dynamics will likely unfold. One reason is that outsiders can voluntarily adhere to the standards and rules of these agreements because this can reduce their transaction costs (Lawrence 2014). Exporters in a third country may also have no choice but to configure their products to meet the particular standards of one very large market—but once they do, they are more likely to retain the same configuration in other markets. Indeed, mega-regionals can create a self-perpetuating network dynamic: as more members join the network, the more benefits there are in joining. A “race to conform” to a common standard develops. In addition, if the members of a deep regional agreement are prepared to grant one another concessions, they are more likely to be willing to grant other countries similar benefits, both in RTAs and multilaterally.

Countries forging agreements could (and should) consciously cultivate these potential benefits from integration. There are three ways in which this can be accomplished.

- *Policy Option 1: Furthering the ex ante understanding of the potential impact of agreements on outsiders.* Countries negotiating agreements can be more deliberate about including in their agreements standards that outsiders will voluntarily adopt, and on creating markets that are more easily contested by non-parties. This process could be aided through “Multilateral Impact Statements” that are designed by a think tank or a panel of trade experts and that encourage negotiators to design agreements that provide benefits to outsiders as well as to the participants. Such a system could mimic the federal guidelines for US policy-makers to take into account the environmental impacts of their actions by requiring all qualifying measures to be subject to an environmental impact assessment. The purpose of these efforts is not necessarily to prevent the measures from being implemented, but rather to raise awareness and encourage policies that minimize environmental impact.
- *Policy Option 2: Advancing trade facilitation and customs modernization via RTAs.* In addition to improving RTA disciplines, there are several ways in which RTA members can expand trade with outsiders. For example, trade facilitation, customs modernization, and improvements in infrastructure among RTA members benefit all countries, not just insiders. Such measures should be prioritized, as they tend to create trade gains that are far greater than those realized from new market access. They are also politically easier to accomplish than renegotiating existing agreements or negotiating new ones. However, they tend to require new investments and development assistance to be realized.
- *Policy Option 3: Encouraging the cumulation of origin.* There are opportunities to create greater coherence among RTAs. For example, in the TTIP, the US and EU can unravel the spaghetti bowl of RoO in the many RTAs they each have in place by implementing the same RoO and allowing for diagonal cumulation across all these agreements. This measure would instantly bring about greater coherence in the global trading system and help companies create economies of scale and reduce transaction costs, as well as help smaller “spoke” economies to benefit. Such an effort would not be entirely novel. Some groups of countries have made

concrete progress towards converging their bilateral and plurilateral RTAs into broader integration blocs—to use a gastronomic analogy, building “lasagna plates” from the RTA “spaghetti bowl.” Recently, Chile, Colombia, Peru, and Mexico harmonized the rules of origin of their various bilateral RTAs with each other in the context of their common integration scheme, the Pacific Alliance. The most prominent example of cumulation is the EU’s Pan-Euro system of cumulation. Created in 1999, the system essentially merged all bilateral RTAs between the EU and various Eastern European nations into a single agreement with a single RoO protocol. The Pan-Euro RoO have subsequently been transposed to the EU’s extra-regional FTAs.<sup>8</sup>

### 3.2. Using Plurilateral Approaches to Multilateralize RTAs

One of the critical challenges that lies ahead is how the WTO system and the RTA system can be made more synergistic and help deepen and enhance each other. Given that the WTO’s “one size fits all” single undertaking approach no longer works, plurilateral agreements—broad-based agreements among subsets of the WTO membership—offer a path forward. They also provide a means to pioneer entirely new rules and market access commitments in an otherwise clogged system. There are ongoing plurilateral negotiations towards a Trade in Services Agreement (TiSA—taking place outside the WTO) and the Environmental Goods Agreement. There are calls for plurilateral agreements in areas such as investment as well as data flows, and ideas are being put forward for negotiating a “sustainable” plurilateral (Draper and Dube 2013) and an agreement aimed at enabling global value chains. However, for plurilaterals to be truly effective and integrative, three reforms are needed.

- *Policy Option 4: Changing the negotiation modalities in the WTO.* It can certainly be argued that for WTO members to allow for plurilaterals means that the MFN principle loses its force, unless plurilateral commitments are negotiated on an MFN basis. However, this latter idea would defeat the purpose of plurilaterals as agreements among coalitions of the willing that alone assume the rights and obligations of the plurilateral. And, to put it bluntly, WTO members that do not accept plurilaterals will drive countries to negotiate more RTAs and mega-regionals and advance their trade interests outside the WTO system. In fact, offering a venue for plurilaterals may be the primary means for the WTO to remain relevant and impactful in the global trading system. It is also perhaps the most meaningful opportunity for WTO members, including less developed economies that are outsiders to plurilaterals (and mega-regionals), to be able to participate in shaping the future of the world trading system. The WTO membership needs to agree on a shift from the current unanimity rule and single undertaking

principle to enable faster deals among a critical mass of members. This critical mass should preferably be commercially meaningful—for example, plurilaterals could be required to include members whose cumulated trade is more than half of world trade. Such a rule could also help members decide which plurilaterals merit negotiation.

- *Policy Option 5: Establishing a common multilateral code of conduct for negotiating plurilateral agreements.* There are no common guidelines for negotiating plurilaterals. Countries should negotiate a multilateral code of conduct to govern the subsequent negotiation of plurilaterals in the context of formal WTO processes. Such a code could allay concerns about plurilaterals and provide members with guidance on ways to proceed. The code should define, for example, that: membership in plurilaterals is voluntary; participants need to have the means to implement the agreement; the issue subject to a plurilateral negotiation should have substantial support in the WTO; only parties to a plurilateral can initiate disputes related to the plurilateral; cross-agreement retaliation is prohibited; and, members should not have to provide the benefits of plurilaterals to non-participants.
- *Policy Option 6: Opening plurilaterals to outsiders.* WTO members willing to sign onto a plurilateral agreement should be able to do so. This has been part of standard practice, including in the plurilateral agreements on government procurement and information technology. Of course, in exclusive plurilaterals, such as the Government Procurement Agreement, WTO members left outside do not gain access to the benefits nor do they need to comply with the obligations until acceding to the Agreement. The WTO could create a “linking” mechanism whereby the commitments of new plurilateral agreements could be extended on an MFN basis to third parties willing to adhere to these commitments, thus gradually multilateralizing plurilaterals. The risk that less developed countries may remain outside plurilaterals is real, however, and could perhaps best be bridged through a concerted effort directed at technical assistance and capacity-building. This, of course, presupposes a willingness on the part of these economies to accede to the newly created system.

### 3.3. Fresh Idea Generation and Information Sharing: The RTA Exchange

The implementation, application, and real-time monitoring of RTAs are suboptimal, and there is a dearth of systematic and sustained global thinking about ways to perfect the RTA system. Although RTAs are emerging as the centre of gravity in global commerce, to date, there is no institution or body that systematically brings together all relevant information on RTAs around the world—let alone foster dialogue, the sharing of experiences, and capacity-building in negotiating

<sup>8</sup> This increased trade between the Eastern European spokes by 7–22% and in the benefiting sectors by 14–72 percent (Augier et al. 2005, 2007). Harris and Suominen (2008) find that, over the past 50 years, adding partners representing 10% of world output to a “cumulation zone” is associated with a 3% increase in the bilateral trade of small countries. Importantly, this is a net effect, including any reduction in trade due to trade diversion.

and implementing RTAs. There is no dedicated forum that encourages global “mindshare” and “idea-generation” on ways to broaden and deepen trade integration on the back of existing and future RTAs, and on ways to build synergies among RTAs and with the WTO system. This is a lost opportunity, but also a gap that can be bridged through a new institution: the RTA Exchange (for further discussion, see Suominen 2014).

- *Policy Option 7: Furthering dialogue and the generation of ideas on ways to make RTAs work for trade and development: the RTA Exchange.* The Exchange is conceived as a first-class global venue for information-sharing, idea-generation, e-learning and capacity-building on diverse practical and strategic aspects related to RTAs among a broad and diverse set of stakeholders—e.g. private sector leaders, policy-makers, development practitioners, and analysts. While the WTO could lead this effort, politics among the membership have made it impossible. As a result, an international coalition has taken the lead: the Inter-American Development Bank, in collaboration with the Asian Development Bank and ICTSD, are in the process of establishing such a platform (Box 1). This pioneering initiative deserves broad support.

**Box 1:** RTA Exchange: A New Platform for Ideas, Learning, and Information Sharing

The Inter-American Development Bank, in collaboration with the Asian Development Bank and the International Center for Trade and Sustainable Development, is developing the RTA Exchange as a dynamic online platform and forum. It aims to: facilitate the sharing of information, ideas, experiences and good practices on RTAs; further capacity-building of negotiators and governments to negotiate and implement RTAs while also assisting companies to operate in RTAs globally; regularly take stock of the general public’s views on policies related to RTAs; survey private sector perspectives on the functioning of RTAs; and, encourage idea-generation to advance convergence and coherence with the multilateral system.

The RTA Exchange is an inherently bottom-up venue driven by its users. It includes various modes to engage users:

- *Clearing house of information:* A highly interactive website with a comprehensive and ever-growing body of information, data, and analysis on RTAs, curated from sources around the world.
- *Forum for engagement among stakeholders:* Regularly updated videos, blogs, announcements, and surveys, as well as ideas and analyses posted by contributors from around the world. The forum also includes a Wikipedia for experts on RTAs.
- *Discussion space:* A user-driven community and social network linking the various stakeholders, with lightly moderate discussions.

- *Webinars for education:* Frequent e-learning, such as online seminars engaging diverse experts on various aspects related to RTAs. Registered members can suggest topics for these seminars.

The RTA Exchange is built on the premise that rather than being viewed as antithetical to the multilateral trading system, RTAs must be seen as an opportunity to accelerate and deepen global trade liberalization, integration, and development. What has been lacking is a transmission mechanism between these objectives and the wealth of dispersed information, analysis, and collective international knowledge on RTAs. The RTA Exchange, fully launched in 2016 and accessible at [RTAexchange.org](http://RTAexchange.org), offers such a mechanism.

# 4. Next Steps: Making RTAs Work for Trade and Development

The WTO is at a defining moment. It faces ongoing questions about its legitimacy and effectiveness, and is surrounded by an increasingly vibrant system of RTAs. Regionalism has long been seen as competing with and undermining the multilateral trading system. Yet, at a time when the WTO is struggling to adjust to an increasingly complex global economy and an evolving constituency, RTAs must be viewed as important constituents of the 21st century multilateral trading system. RTAs have increased trade and investment, deepened relationships among countries, and paved the way for broader cooperation among members. They have manifestly been far more successful than the WTO system in advancing economic integration around the world and in creating new rules that respond to emerging needs in the marketplace.

This paper has put forward seven short to medium-term policy options aimed at addressing unresolved challenges in the RTA system in the interest of stimulating international trade and development. These options fall under three broad headings: furthering synergies between RTAs and third parties; using plurilateral approaches as a vehicle for advancing integration among large subset of WTO members; and, establishing the RTA Exchange. While the Expert Group recommendations for reform are being pursued, longer-term thinking and engagement needs to start on the future of RTAs, especially in light of the new patterns and trends described in the concluding section below.

## 4.1. Preparing for Future Patterns in Economic Integration

*New geography of integration:* RTAs of the past 20 years have been negotiated among relatively small groups of players and they have yet to be concluded among the largest trading powers. However, the TPP (which reached agreement in October 2015) and the TTIP (in which negotiations are ongoing) are changing the geography of formal trade integration. Looking further into the future, additional transformations could unfold. For example, the TPP and TTIP will almost *de facto* merge into a “super-deal.” After all, the US and EU already have bilateral agreements with several common partners in the TPP—Peru, Colombia, Chile, Australia, Singapore, Canada, and Mexico (the EU and Japan are also in the process of negotiating a bilateral FTA). It would thus not be a major leap to merge in some way the two agreements. As gatekeepers to markets with two-thirds of global spending power, the two agreements, alone and certainly combined, would also be attractive “docking stations” for outsiders. For example, if China and Brazil were to join, a TTIP-TPP super-deal would cover 80%

of global output. In this scenario, the WTO and (a large) part of its membership would be marginalized, and all meaningful action on trade policy-making would move to the RTA sphere—where questions such as outsider treatment and the management of disputes would become central.

*Unfolding geoeconomics of trade:* Even though the US, EU, and Japan will remain central to the world economy and trade flows for the foreseeable future, new dynamics in North-South and South-South trade are poised to gain in significance over the coming years. In all probability, China in particular will play an increasingly important role in world trade, the trade policy and geoeconomic considerations of individual nations, and in developments at the multilateral level. Some analysts have suggested that China may opt for a division of labour (or perhaps for the creation of spheres of influence) where China leads an Asian track of trade integration while the US pursues its pivot to Asia via the TPP. Others have proffered an alternative scenario where China decides to join the TPP so as to secure the rights and benefits the agreement confers to its members. Perhaps the likeliest scenario lies somewhere in between, especially given the considerable overlap between TPP and RCEP membership. In the scenario where China decides to work with, rather than against, the TPP, and use it to supplement the RCEP, plurilateral initiatives could become easier to realize.

*New technology drivers:* The priority for trade negotiators over the past 20 years has been to accommodate corporate supply chains by freeing trade and securing national treatment for foreign investors around the world. Today, however, new technologies such as e-commerce, the cloud, 3D printing, and the Internet of Things are revolutionizing world trade and production, and creating new challenges for policy-makers in areas such as intellectual property of 3D printed designs, regulation of cross-border data flows, and taxation of digital trade. However, given the rapid pace of technological change, it is not obvious that traditional, multi-year, and hard law trade negotiations serve the purpose they did in the past: rules agreed to today may prove counterproductive tomorrow. As such, the technology for negotiating trade agreements will probably need to change. For example, future commitments may more appropriately be developed as norms and codes of conduct.

*The shrinking players:* The advances of e-commerce and information technologies are opening new opportunities for entrepreneurs and small businesses around the world to engage in trade. To give a simple example: while only 5% of US brick and mortar businesses export, 97% of US eBay sellers ship their products to foreign markets.

And while the average US exporter sells to one or two overseas markets, eBay sellers that export sell on average to 19 markets. The fact that small businesses are now able to engage in trade at a relatively low cost creates new challenges for rule-making and the implementation of RTAs, not least because small businesses seldom have the capacity to interpret or apply complex trade disciplines. The implementation of RTAs will need to adjust to accommodate these new entrants in international trade. For example, governments can provide new tools for small and medium-sized enterprises to understand market access rules in their product categories across RTAs, and to access simplified forms and procedures for customs clearance.

In conclusion, as the world changes and the needs of companies and consumers evolve, RTAs can provide an enabling framework but will not suffice to meet the challenges that lie ahead. Multilateralism is also critical: global system manager institutions play a central role in ensuring non-discrimination and settling disputes. Ideally, RTAs and the WTO system will move in parallel and strengthen each other. The WTO is uniquely placed to provide a global venue for its members to discuss best practices in RTAs, negotiate plurilateral agreements, and generate ideas on new ways to use the RTA system for greater efficiency in global trade and investment. The WTO membership should embrace this opportunity.

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The papers commissioned for the E15 Expert Group on Regional Trade Agreements and Plurilateral Approaches can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status and Gap	How to Get There
<b>Furthering the potential benefits of RTA integration with third parties</b>			
1. Further <i>ex ante</i> understanding of the potential impact of RTAs on outsiders and the extent to which they promote a more integrated global trading system.	Short term	The design of RTA disciplines essentially reflects the concerns of domestic constituencies with the effect on third parties considered at best as an after-thought. There is no conscious effort at promoting potential benefits for third countries.	Think tank or panel of trade experts to design guidelines for an <i>ex ante</i> “Multilateral Impact Statement” (e.g. mirrored on US federal guidelines for policy-makers on environmental impact assessments).
2. Advance trade facilitation and customs modernization through RTAs as a way to expand trade and ensure benefits with third countries.	Medium term	WTO Trade Facilitation Agreement remains relatively narrow. A broad focus on trade facilitation, including soft and hard infrastructure, is likely to produce significant gains and might be easier to achieve.	Integrate relatively similar/homogenous trade facilitation disciplines in RTAs as a way to accelerate the convergence of disciplines at the multilateral level.
3. Design rules of origin in a way that allows for cumulation of origin across RTAs or GSP schemes (diagonal cumulation).	Medium term	There is a limited set of precedents allowing for cumulation among a uniform set of RoO across members of an RTA (e.g. Pan-Euro RoO protocol, Pacific Alliance harmonization initiative).	EU and US to harmonize their RoO under TTIP and extend them to all their respective RTAs/GSP schemes allowing for diagonal cumulation.
<b>Using plurilateral approaches as a means to multilateralize the benefits of RTAs</b>			
4. Move beyond the unanimity rule and single undertaking principle and use the WTO as venue for negotiating all future plurilateral initiatives.	Medium term	<ul style="list-style-type: none"> <li>– In face of WTO stalemate, plurilaterals might offer a way forward to keep centrality of MTS;</li> <li>– Inclusive plurilaterals (i.e. extending benefits on MFN basis) require critical mass but are not problematic from a WTO acceptance perspective;</li> </ul>	<ul style="list-style-type: none"> <li>– Introduce the notion of a code of conduct into formal WTO processes defining principles and a set of rules governing future plurilateral initiatives;</li> <li>– Identify areas where potential plurilateral initiatives might gather sufficient “critical mass” of interest among WTO membership;</li> </ul>
5. Establish a multilateral code of conduct for negotiating plurilateral agreements in advance of any formal WTO plurilateral processes.	Medium term	<ul style="list-style-type: none"> <li>– Exclusive plurilateral (e.g. GPA) face more challenges in gathering acceptance by the rest of WTO members;</li> <li>– Need to define <i>ex ante</i> principles on the rights and obligations of plurilateral members and non-members.</li> </ul>	<ul style="list-style-type: none"> <li>– Design mechanism through which third parties can adhere to the commitments under exclusive plurilaterals to pave the way for progressive multilateralization once critical mass is reached.</li> </ul>
6. Create a “linking” mechanism to extend the benefits of plurilateral agreements on an MFN basis.	Medium term		

Policy Option	Timescale	Current Status and Gap	How to Get There
<b>Idea generation and information sharing: the RTA Exchange</b>			
<b>7. Establish and support the “RTA Exchange” as an independent knowledge and dialogue platform on the interface between RTAs and the WTO and as an information pool for developing countries.</b>	Short term	<ul style="list-style-type: none"> <li>– No single instance bringing together all relevant information on RTAs and fostering dialogue, sharing of experience and knowledge generation on ways to enhance coherence between RTAs and the WTO.</li> <li>– Developing countries, and least developed countries in particular, would benefit from knowledge sharing and support to negotiate, implement, apply, and join RTAs.</li> </ul>	<ul style="list-style-type: none"> <li>– International coalition of think tanks and IGOs to take the lead in establishing the knowledge and dialogue platform of the RTA Exchange (ICTSD, IDB, ADB).</li> </ul>

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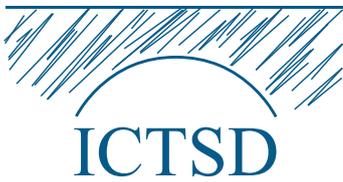
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# Regulatory Cooperation: Lessons from the WTO and the World Trade Regime

Policy Options Paper



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# Regulatory Cooperation: Lessons from the WTO and the World Trade Regime

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on behalf of the E15 Task Force on Regulatory Systems Coherence

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Task Force on Regulatory Systems Coherence. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Petros C. Mavroidis was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

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# Abstract

Trade friction today is largely due to regulatory diversity as contemporary markets are chiefly segmented through non-tariff barriers. The purpose of the paper is to enquire into regulatory cooperation and coherence in the context of the world trade regime. It examines the challenges arising from regulatory diversity and considers mechanisms and approaches that could be taken to reduce regulatory barriers and costs to trade. Following an assessment of how countries are currently pursuing regulatory cooperation in the context of preferential, plurilateral and multilateral initiatives, with the Agreement on Technical Barriers to Trade and the Agreement on Sanitary and Phytosanitary Measures under the aegis of the WTO adopted as the baseline, a set of options for policies and international trade rules that will enhance regulatory cooperation are put forward. The main recommendations concern transparency in the formulation of policies, the interaction between affected parties when

preparing and adopting regulatory measures that could impact on trade, and the establishment of fora where these discussions and commitments may take place. The options are divided into two categories: institutional and substantive. The former is dedicated to issues attendant to participation, while the latter is concerned with improving existing obligations and developing new mechanisms for cooperation. The paper acknowledges that developing countries with a limited administrative apparatus may find some of the options difficult to implement, and thus underscores the need for capacity building. It concludes that a mechanism of “reasoned transparency” will bring the trade and regulatory communities together, which should become one of the pillars of the WTO. The organization should add a function akin to an Information Exchange regime covering all forms of regulatory cooperation.

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Abbreviations	
AfT	Aid for Trade
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
APEC	Asia-Pacific Economic Cooperation
CCC	China Compulsory Certification
CMA	critical mass agreement
CRO	common regulatory objectives
CUSFTA	Canada-United States Free Trade Agreement
DSU	Dispute Settlement Understanding
EU	European Union
FSANZ	Food Standards Australia New Zealand
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GPA	Government Procurement Agreement
GRP	Good Regulatory Practice
GVC	global value chain
ILAC	International Laboratory Accreditation Corporation
ISO	International Organization for Standardization
ITA	Information Technology Agreement
MRA	mutual recognition agreement
NAFTA	North American Free Trade Agreement
NGO	non-governmental organization
NTB	non-tariff barrier
OECD	Organisation for Economic Cooperation and Development
PA	plurilateral agreement
PTA	preferential trade agreement
RAPEX	Rapid Alert System for non-food dangerous products
RCC	Canada-United States Regulatory Cooperation Council
SPS	sanitary and phytosanitary
SSO	standard-setting organization
STC	specific trade concern
TABC	Transatlantic Business Council
TABD	Transatlantic Business Dialogue
TACD	Transatlantic Consumer Dialogue
TBT	technical barriers to trade
TNC	transnational corporation
TTIP	Transatlantic Trade and Investment Partnership
TTMRA	Trans-Tasman Mutual Recognition Agreement
UNECE	United Nations Economic Commission for Europe
US	United States
WTO	World Trade Organization

# Executive Summary

The focus of the paper is on regulatory cooperation and regulatory coherence in the context of the world trading system. The intensity of cooperation can vary. On one end of the continuum it could be an agreement to talk and on the other it could lead to the recognition of regulatory processes as equivalent. The key questions are: why promote either or both regulatory cooperation and coherence, and what are the mechanisms that can best help ease the tensions resulting from the expression of asymmetric domestic policies?

To address these issues, ICTSD, in partnership with the World Economic Forum, convened a group of experts, as part of the E15 Initiative. The European University Institute joined forces in this endeavour. The mandate was to propose solutions to improve the world trade regime. A bottom-up approach was privileged to identify specific areas where problems have arisen due to a lack of cooperation and also evaluate existing mandates on regulatory cooperation in the WTO and in preferential trade agreements (PTAs). The resulting assessment of the distance between present and desired levels of cooperation provides the basis on which the policy options are outlined. Two aspects of this work deserve to be underlined. First, cooperation involves the gathering of two communities that have rarely communicated with each other in the past: the trade and the regulatory community. A guiding principle has been to advance proposals that aim to bridge this gap. Second, developing countries may find some of the options difficult to implement. The need for capacity building is thus underscored, most prominently under the Aid for Trade (AfT) initiative.

## Regulatory Cooperation: Where are we now?

The aim is to provide input to the WTO regarding the manner in which it could better serve its current and anticipated workload. This trade perspective is not exhausted within the confines of the WTO regime. There are many initiatives focusing on regulatory cooperation that take place outside of the WTO, either formally within PTAs or informally. As can be expected, there is much more activity and intensity at the PTA level. The baseline adopted in the paper is cooperation in the context of two multilateral agreements: the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary (SPS) Measures. These are the most far-reaching examples of regulatory cooperation in the WTO.

### *Regulatory cooperation in the GATT*

In the GATT world, disciplines on regulatory barriers were mainly intended to ensure that tariff reductions would not be circumvented through the substitution of policy instruments. Following the founding of the WTO and the declining role of tariffs, commitments on regulatory barriers have a different function: they are market-integrating devices. The basic recipe under the GATT for addressing non-tariff barriers is non-discrimination. Non-discrimination conditions market access on the capacity of products to meet standards unilaterally decided by an importing state. It has nothing to say about the quality of the regulatory intervention, nor on regulatory diversity.

### *Regulatory cooperation in the WTO*

The WTO contract allows for new avenues to integrate beyond non-discrimination. The TBT and SPS Agreements provide a mix of disciplines that promote recognition of the impact that the unilateral exercise of regulatory authority may entail. The WTO, through the disciplines imposed by these agreements, addresses the quality of regulatory intervention. Moreover, members are not free to adopt any measure they deem appropriate as long as it is applied non-discriminatorily. The TBT and SPS Agreements, which cover a subset of regulatory activity dealing with issues of public health, consumer protection, environmental protection, etc., do not require from WTO members that they adopt first best policies. They do oblige them, nonetheless, to adopt measures that have the least impact on trade, that are non-discriminatory, and where transparency has been observed. They have not resulted in eliminating trade costs. The unilateral definition of policies continues to be the mainstream scenario—cooperation being relegated to best endeavours.

### *Regulatory cooperation within preferential trade agreements*

While PTAs originally addressed classic trade barriers, they have evolved into mechanisms that seek to promote regulatory cooperation, which can be achieved with greater ease between a subset of the WTO membership. The most far-reaching examples of cooperation are between homogeneous players. They are not exclusively between such players however: homogeneity is a facilitating factor. Regulatory cooperation between heterogeneous players is often more targeted on specific product categories.

### *Clubs with open doors*

WTO plurilateral agreements constitute another club approach to integration. Plurilaterals can be formed by a subset of the WTO membership, provided that the remaining WTO members have acquiesced to a demand to this effect. There is thus some *ex ante* control on their

subject matter. Their practical relevance so far has been limited to the liberalization of the government procurement market. In addition, critical mass agreements constitute a negotiating technique to reduce the impact of free riding. Unlike plurilaterals, they have no institutional underpinning in the Agreement establishing the WTO.

## Policy Options: From Current to Desired Cooperation

The options concern transparency in the formulation of policies, the interaction between affected parties when preparing and adopting measures, and the establishment of fora for discussion. When proposing policies, there is often a trade-off between ambition and realism, and a guiding principle has been to maximize both values to the extent feasible. The options are as close as possible to a first best solution having evaluated alternatives. They are divided into institutional and substantive categories. The former are dedicated to issues of participation. The latter concern the improvement of existing obligations and mechanisms for cooperation.

### *Institutional recommendations*

#### *Clubs – Promote recourse to plurilateral agreements*

The WTO should actively promote regulatory cooperation within clubs and develop mechanisms that enable the multilateralization of clubs-only agreements. The establishment of plurilateral agreements should be sanctioned unless WTO members representing a combined threshold of world trade (e.g. 20%) are opposed. The WTO should particularly encourage plurilaterals that deal with issues that do not come under the existing mandate.

#### *Business Access – The WTO should open to business interests*

Business interests should be in a position to continue voicing their concerns. Participation should be encouraged and requests for observer status should not be refused except for compelling reasons to be transparently communicated. In designing this observer status, the WTO could be inspired by the Industry Advisory Committee of the OECD or the Business Advisory Council of the Asia-Pacific Economic Cooperation. Representation should not be confined to areas covered by the TBT and SPS Agreements.

### *Substantive recommendations*

#### *Transparency – Strengthen and consolidate transparency disciplines*

The current transparency obligation must be consolidated and strengthened in five directions: (i) there should be a “mapping” of national mechanisms that are intended to provide transparency with respect to national regulatory processes; (ii) WTO members should notify all adopted measures, whether based on international standards or not; (iii) they should explain the rationale behind their measures (“reasoned transparency”); (iv) they should involve affected parties at an early stage in the process; (v) they should use the reasonable interval between publication and entry into force of a measure to fine-tune regulation.

#### *Impact assessment – Conduct ex post evaluations of the impact of adopted measures*

The original *ex ante* assessment of the impact of a proposed regulation should be accompanied by an *ex post* assessment of the trade impact of adopted measures. To the extent that discrepancies between the expected outcome and the observed impact exist, national administrations could revise their *a priori* assumptions so as to design more efficient regulations in the future.

#### *International standards – Recourse to international standards should be encouraged*

Article 2.4 of TBT could be further strengthened. Besides encouraging the use of international standards in principle, it could make it clear that deviations from international standards should be justified by the deviating state. The same provision should be enriched in two ways: through an explicit reference of the 2000 Decision and through the addition of an indicative list of standard-setting organizations.

#### *Private Standards – Clarify the relevance of the WTO on private standards*

The WTO should dedicate a forum to the issue. It could be inspired by prior endeavours such as the 1971 Working Party on Border Tax Adjustments. Instead of continuing along the current top-down approach, it would be more opportune to dedicate to sector-specific negotiations.

## Next Steps

An appropriate way to rationalize the quality of regulatory interventions at home is by looking at the best examples elsewhere and mimic them. Reasoned transparency should become a priority. It is through this mechanism that the trade and the regulatory communities will be brought around the same table, which should become one of the pillars of the WTO. All the proposals seek to further an institutional innovation that would promote regulatory cooperation across the WTO membership on a sustainable basis. The paper encourages the current initiatives undertaken in the context of the TBT and SPS Committees. They should be improved and also reproduced in other areas. Alternatively, the WTO could envisage establishing a Working Group on Transparency where all the options could find a home for deliberation. The organization should add a function akin to an Information Exchange regime for all forms of regulatory cooperation.

# 1. Introduction Remarks

## 1.1. Mandate

The focus of this paper is on “regulatory cooperation” and “regulatory coherence.” Neither of these two terms is prone to a very precise definition, and the contexts in which they are, or have been, used matters. During the ongoing Transatlantic Trade and Investment Partnership (TTIP) negotiations between the European Union and the United States, for example, the two terms have been defined as follows (US Chamber of Commerce 2015).

‘Regulatory cooperation’ is the process of interaction between U.S. and EU regulators, founded on the benefits regulators can achieve through closer partnership and greater regulatory interoperability. ‘Regulatory coherence’ is about good regulatory practices, transparency, and stakeholder engagement in a domestic regulatory process.

Thus, whereas the first term would denote the presence of an international element, the second term describes the quality of a domestic regulatory process. Of course, domestic regulatory processes are influenced by the quantity and quality of regulatory cooperation.

We understand the number of players involved as the “extensive margin” of regulatory cooperation, and the intensity of cooperation as the “intensive margin.” WTO 2.0 should be some sort of information exchange regime about all forms of regulatory cooperation happening between clubs (and the whole membership, whenever feasible). It should further develop criteria for selecting issues of cooperation that can move from the club to the multilateral level.

The intensity of cooperation can obviously vary. On one end of the continuum it could be an agreement to talk, and on the other it could lead to the adoption of common standards and/or recognition of each other’s regulatory processes as equivalent. And then there are variations of these forms as well. OECD (2013), to which we refer in more detail *infra*, provides an inventory of various types of cooperation and distinguishes between eleven categories of different intensity.

The key question is why promote either or both regulatory cooperation and coherence? In response, these are instruments that can help ease the tensions resulting from the expression of asymmetric policies (Hoekman (2015) offers a comprehensive discussion). The objective matters though. It is one thing to promote regulatory cooperation in order to address an environmental hazard. It is a different thing to do so in order to integrate markets.

The E15 Task Force was mandated to enquire into regulatory cooperation/coherence in the context of the world trade regime. The primary focus was to enquire into the problems in integrating markets posed by the current state of cooperation, and propose solutions to improve the regime. An attempt has nonetheless been made to expand the scope of the paper in such a way that (some of) the lessons learned from the study of the world trade regime can be extrapolated in other areas where regulatory cooperation/coherence can help achieve gains for global welfare.

## 1.2. Scope

The issues this policy options paper seeks to address focus on the world trade regime (i.e. the WTO and the various preferential trade agreements or PTAs). How is market integration impeded (or, alternatively, how can it further be aided) through the current state of regulatory cooperation across trading nations? What are, in other words, the costs resulting from the existing level of cooperation on the regulatory front? The paper seeks to identify the most appropriate existing mechanisms for addressing them, as well as preferred approaches to do so.

Contemporary markets are segmented essentially through regulatory, non-tariff barriers (NTBs), following the GATT’s success in dismantling tariff barriers. Trade friction is largely due to regulatory diversity. Indeed, the very high number of specific trade concerns (STCs) raised so far before the Technical Barriers to Trade (TBT) Committee is probably the best evidence to this effect: 460 had been raised by July 2015.<sup>1</sup> Some might argue then, why cooperate? Indeed, would it not be more efficient to simply litigate instead of delving into the intricacies, often byzantine, of regulatory cooperation with players the internal politics of which are often impossible to influence? Litigation is costly and sometimes inaccessible too. STCs do promise fast

<sup>1</sup> See, <http://tbtims.wto.org>. Five of them became “formal disputes” that were raised under the Dispute Settlement Understanding (DSU). Five might seem too low. Claims under the TBT Agreement have been raised in 50 disputes so far, but in only five cases the main concern was a TBT concern. Related numbers for the SPS Agreement are comparable (275/43/10).

relief, but if stakes are high, the defendant might stall and oblige plaintiffs to submit formal disputes to Panels and the Appellate Body. The average length of the formal process is bordering on 5 years. Moreover, only WTO members can access a WTO Panel. This means that business will have to persuade a government to litigate. Governments, however, are sums of interests and might on occasion find it profitable to thwart such requests. Recourse to litigation before domestic courts is also improbable, since WTO members typically do not allow private parties to invoke WTO law before domestic courts except for customs-related issues (WTO law is not “self executing” in US parlance; has no “direct effect” in EU parlance).<sup>2</sup>

The baseline is regulatory cooperation in the context of two WTO agreements: the Agreement on Technical Barriers to Trade and the Agreement on Sanitary and Phytosanitary Measures (SPS). These are the most far-reaching examples of cooperation in the WTO. The issue of regulatory cooperation has also occupied the minds of trade negotiators in the context of the General Agreement on Trade in Services (GATS); Article VI of GATS deals with disciplines on domestic regulation regarding qualification, technical specifications, etc. for services and service suppliers. There is an ongoing discussion regarding regulatory cooperation in this context in order to reduce costs stemming from unilateral regulation. At the time of writing, this process was far from producing sufficiently tangible results that could inspire the present study or recommendations.<sup>3</sup> Our final recommendations though, are not limited to trade in goods, or to the future design of the TBT Agreement for that matter. The policy options that we advance in this paper could find application in other areas of regulatory cooperation. Adjustments might be warranted, but the gist of our proposals is in principle applicable in areas beyond trade in goods.

### 1.3. Recommendations

TBT and SPS evidently cover a subset of regulatory activity, albeit an important one, since they deal with issues of public health, environmental protection, food safety, consumer protection, the fight against fraudulent practices, etc. These agreements do not require from WTO members that they adopt first best policies when aiming to achieve one of the objectives mentioned above. By first best, we understand optimal policies that are targeted and eliminate distortions. The second best theory suggests that when one optimality condition is not met, a (second best) policy that introduces some new market distortion might still be efficient if it removes in part the original distortion. The TBT and SPS Agreements do oblige WTO members, nonetheless, to adopt policies that have the least impact on international trade, that are non-discriminatory and that, on occasion, are consistent and based on science. Alas, they have not

resulted in eliminating trade costs, in part because they are not always faithfully implemented, and in part because the unilateral definition of policies continues to be the mainstream scenario in the WTO world—cooperation being relegated to best endeavours.

A question that occupied the Task Force concerned the degree of ambition when tackling the issue of regulatory cooperation/coherence. One could think of various options here: cooperation could aim at persuading every WTO member to adopt first best policies; it could be restricted to mimicking the most promising example between trading partners in place, even if it has been agreed by a subset of the WTO membership only; and it could also be some sort of incremental improvement on current WTO practices. If, for example, environmental labelling is proven to adequately inform consumers about potential environmental hazards (under assumptions, of course), why have recourse to other more drastic (and probably less efficient) instruments such as import embargoes or other measures?

Policy proposals can be helpful only when immunized with a heavy dose of realism. There is, of course, a trade-off between ambition and realism, and a guiding principle of this paper and the process behind it has been to attempt to maximize both values to the extent feasible.

The policies that are thus proposed are as close as possible to a first best solution, having evaluated the pros and cons of alternatives in case a proposal could be deemed too ambitious.

Four different sources have inspired the Task Force in preparing a recipe for forward momentum and the design of cooperation for the trading community: The current state of affairs in the WTO and PTAs, paying particular attention to the most ambitious forms of cooperation embedded therein; the concerns and sources of discontent of the export-oriented business community; the analysis and experience of organizations and non-governmental organizations (NGOs) dealing with trade as well as regulatory cooperation; and academic writings, both on the policy side as well as theoretical enquiries.

One aspect of this work deserves to be underlined. In today's world, cooperation involves the gathering of two communities that rarely communicated with each other in the past: the trade and the regulatory community. The issue is as much of international as it is of domestic scope. A guiding principle throughout has been to advance proposals that aim to bridge the gap between these communities that operate insulated from each other in many domestic settings.

<sup>2</sup> This has been the case for some time now. An early contribution on this subject concerning EU practice is offered by Vermulst and Waer (1997).

<sup>3</sup> Negotiators have agreed to elaborate new disciplines, see WTO Docs. S/C/W/96, and S/WPDR/W/45. Mattoo (2015) has also studied the role of regulatory cooperation in services agreements. He argues that current regulatory disciplines in the GATS point in the right direction but are insufficient.

It is impossible to provide a generic estimation of the potential gains from regulatory cooperation. It all depends on the product market and the form cooperation will take. Some markets are heavily regulated, with no cooperation at all, and some are the exact opposite. There are various studies that have focused on this issue and sought to provide evaluations of the gains. The OECD has been a pioneer in this endeavour.<sup>4</sup>

With all of this in mind, the recommendations presented in this paper aim to address both the unilateral expression of regulatory concerns as well as cooperation on this front. One might criticize the inclusion of the former in a study aiming to address regulatory “cooperation.” And yet, such criticism is unwarranted. Imposing disciplines on the unilateral exercise of regulatory sovereignty can lead to cooperative outcomes, as shall be shown.

The main recommendations concern transparency in the formulation of policies, the interaction between affected parties when preparing and adopting measures, and the establishment of fora where these discussions can take place.

Finally, an issue that is crucial for many of the recommendations should be noted. The world comprises heterogeneous players of drastically different administrative capacities. Developing countries especially might find it difficult to implement some of the policy options, such as, for example, the measurement of the trade impact of regulations or the use of some international standards. For this reason, it is important to underscore upfront the need for capacity building and the ensuing supply of technical expertise by those who possess it to those who do not. Existing WTO regimes scattered in various agreements, most prominently the Aid for Trade initiative, can facilitate this effort.

<sup>4</sup> The OECD webpage ([www.oecd.org](http://www.oecd.org)) includes various studies on the gains from regulatory cooperation

# 2. Regulatory Cooperation: Where Are We Now?

Regulatory cooperation is being pursued both at the multilateral and preferential level. PTAs increasingly include chapters that cover aspects of the issue. As can be expected, there is much more activity and intensity at the PTA level, especially when PTAs have been concluded between homogeneous players.

## 2.1. Regulatory Cooperation in the GATT

Regulatory cooperation was not much of a concern for the framers of the GATT, who had other, bigger fish to fry. In the GATT world, commitments on regulatory barriers were intended to provide an insurance policy that tariff reductions would not be circumvented through the substitution of policy instruments.<sup>5</sup> In a world where tariffs become increasingly marginal, commitments on regulatory barriers have a different function: they are market-integrating devices. The most dramatic reduction in tariff levels coincided with the advent of the WTO. It is thus after 1995 that the focus shifted towards regulatory cooperation. Some discussion on regulatory cooperation had already started during the GATT Tokyo Round (1973-1979), with the advent of the first TBT Agreement. It is there that the first, shy steps in this direction were taken. This effort, though, was confined to the OECD membership, since the Tokyo Round agreements were a “code” in the sense that participation was voluntary. Only OECD members joined.

How did the GATT address regulatory barriers in general, that is, those that did not come under the Tokyo Round TBT Agreement? The basic recipe under the GATT for addressing NTBs is non-discrimination. Non-discrimination conditions market access upon the capacity of products to meet standards unilaterally decided by the importing state. If not, they will be excluded from that market. Non-discrimination has nothing to say about the “quality” of the regulatory intervention: trading regulations can be “excessive,” that is they might go beyond what is required to achieve the aim pursued, and thus, they can impose huge costs on trading nations. They will still comply with the basic GATT rule, however. Furthermore, non-discrimination condones regulatory diversity and is an insurance policy for those with high levels of protection: they can thwart imports that do not meet their standards.

## 2.2. Regulatory Cooperation in the WTO

Beyond non-discrimination, the WTO contract allows for other more “promising” ways to integrate. The so-called “new generation” agreements, the TBT and the SPS, provide a mix of disciplines that promote recognition of the (negative) impact that the unilateral exercise of regulatory authority might entail.<sup>6</sup> With the advent of the WTO, the TBT Agreement was multilateralized and the first SPS Agreement was signed. Unlike the GATT, the WTO, through the disciplines imposed by these two agreements, addresses the quality of regulatory intervention, and, also unlike the GATT, it does not leave it to its members to decide and adopt whatever measure they deem appropriate as long as they apply it in non-discriminatory manner.

For measures coming under the purview of these two agreements, when WTO members act unilaterally they must adopt the measure least restrictive on international trade, and must base it on international standards if the latter are relevant and appropriate. They must ensure that transparency has been observed. They must also allow intervals between the publication of measures and their entry into force, during which they can accommodate questions regarding the policy rationale and objectives. WTO members can also unilaterally recognize other members’ measures as equivalent to their own. They are further encouraged to rethink the merits of their intervention, assess the impact, and explore alternatives before deciding on the final measure, all of this under a recent initiative entitled Good Regulatory Practice (GRP).<sup>7</sup> With respect to SPS measures only, WTO procedures must further guarantee that interventions are based on available scientific evidence and are consistent when addressing similar risks. WTO members are encouraged to sign mutual recognition agreements (MRAs) and/or harmonize their rules.

The fact is, though, that recognition agreements are routinely signed between like-minded, homogeneous players (often in the context of PTAs), and few participants prepare harmonized standards for the world. Non-discrimination remains largely the baseline for integration at the WTO-level among the majority of WTO members.

<sup>5</sup> A customs duty can be expressed as the sum of a production subsidy and a consumption tax. A discipline on customs duties with no corresponding discipline on the other two instruments could thus prove meaningless.

<sup>6</sup> TBT covers measures relating to the obligation of producers to indicate the composition and/or production process of their goods, whether they revert to the form of labelling/packaging or not. SPS covers measures aimed to protect human, animal health, and/or the environment from pests and diseases.

<sup>7</sup> This is an initiative that has been adopted recently and urges WTO members to adopt policies that best address perceived distortions. The WTO has been investing resources to increase technical capacity in this respect. See

[https://www.wto.org/english/tratop\\_e/tbt\\_e/wkshop\\_march08\\_e/wkshop\\_march08\\_e.htm](https://www.wto.org/english/tratop_e/tbt_e/wkshop_march08_e/wkshop_march08_e.htm)

### 2.3. Regulatory Cooperation within Preferential Trade Agreements

If we exclude cooperation in the EU, all intra-PTA cooperation takes place within free trade agreements (FTAs), which occasionally include chapters to this effect. FTAs are closed clubs—i.e. conditions for accession for outsiders are not spelt out *ex ante*. Accession depends on agreement with the incumbents.

The most far-reaching examples for regulatory cooperation are between homogeneous players. This is not to say that they are exclusively between such players. Homogeneity is a facilitating factor, not a *conditio sine qua non*.

Originally, PTAs addressed classic trade barriers, e.g. tariffs and quantitative restrictions. Eventually, they evolved into mechanisms that promote regulatory cooperation, which can be achieved with greater ease between a subset of the WTO membership.

The US and Canada have been partners in the North American Free Trade Agreement (NAFTA) for over twenty years, and bilateral partners for even longer (the Canada-United States Free Trade Agreement, or CUSFTA, predates NAFTA). Besides cooperation under NAFTA, they have established their own Canada-United States Regulatory Cooperation Council (RCC). The accounts regarding its overall record are consistently positive, and there is ample evidence to the effect that the RCC is quite active in discussing standards, but also in reducing or eliminating friction resulting from regulatory divergence (Wolfe 2014).

New Zealand and Australia first signed the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), and then entered into a wide MRA, the Trans-Tasman Mutual Recognition Agreement (TTMRA). As illustration, it is worth mentioning a notable output of this initiative, the Food Standards Australia New Zealand (FSANZ). It focuses on cooperation in the preparation of food at an early stage (i.e. not subsequent to the adoption of national laws), and in measuring the trade impact of proposed measures. It is acknowledged that the initiative has largely contributed to the strengthening of economic relations between the two countries.<sup>8</sup>

Then there are examples of more recent PTAs that have mainly focused on regulatory cooperation. Take the case of transatlantic relations. The transatlantic partners, who are currently engaged in the TTIP negotiations, have a long history of regulatory cooperation: the Transatlantic Economic Partnership (1998); the EU/US Positive Economic Agenda (2002); the EU/US Economic Initiative (2005);

and the Framework for Enhancing Transatlantic Economic Integration (2007). In parallel, there is an informal business dialogue, the Transatlantic Business Dialogue (TABD),<sup>9</sup> and the Transatlantic Consumer Dialogue (TACD). There is consensus that these initiatives, formal and informal, have led to few changes on the regulatory front on either side of the Atlantic, but have substantially contributed in reducing trade friction.<sup>10</sup> Moreover, they may have contributed towards the initiation of the TTIP negotiation, the formal “roof” to host and further promote all of these initiatives.

Regulatory cooperation also exists between heterogeneous players. However, it is often more targeted. Negotiators discuss specific product categories and aim to reach solutions and build on prior success. A good example is the EU-China Regulatory Cooperation Framework. It is an initiative between government entities focusing on product safety. The Rapid Alert System for non-food dangerous products (RAPEX) is the mechanism instituted to investigate specific products (product categories). By 2010, 4,885 cases had been identified and investigation had been initiated in 1,678 cases.<sup>11</sup>

China signed its first MRA with New Zealand, which has a very narrow scope as it concerns electric and electronic equipment and components, and works to the benefit of New Zealand producers. Before the agreement, New Zealand exporters had to test compliance with electrical safety and electromagnetic compatibility regulatory requirements on Chinese soil. There was uncertainty since no one could assure *ex ante* (before export) that products were indeed compatible with Chinese standards. Following signature of the MRA, New Zealand producers can affix the China Compulsory Certification (CCC) label on their goods before export from New Zealand. They can do so following accreditation and conformity assessment procedures carried out by New Zealand agencies formally accepted in China. One can easily see that uncertainty is eliminated in this way.

There are also initiatives with wider content (i.e. that are not *a priori* limited to the examination of specific products) between heterogeneous players. The EU has chapters on regulatory cooperation in the successor agreements to the Lomé Convention with many of its African ex-colonies. They typically involve best endeavours clauses, however, with no binding obligations included therein (Horn et al. 2010).

<sup>8</sup> See, Australian Government and New Zealand Government Productivity Commissions. 2012. Strengthening Trans-Tasman Economic Relations, [www.pc.gov.au/inquiries/completed/australia-new-zealand/report](http://www.pc.gov.au/inquiries/completed/australia-new-zealand/report)

<sup>9</sup> Recently consolidated and formalized under the auspices of the Transatlantic Business Council (TABC).

<sup>10</sup> WTO Doc. G/TBT/W/348 of February 14, 2012. On TABD, see Quick (2008) who discusses the process in detail and shares this conclusion.

<sup>11</sup> WTO Doc. G/TBT/W/348 of February 14, 2012.

## 2.4. Clubs with Open Doors

And then there are clubs with open doors: WTO plurilateral agreements (PAs). Plurilateral agreements can be formed by a subset of the WTO membership, provided that the remaining WTO members have acquiesced to a demand to this effect. There is thus some *ex ante* control on their subject matter, and their subjection to voting by the membership is the means to ensure that any such arrangement is Pareto-sanctioned.<sup>12</sup> They constitute yet another club approach to integration. However, their practical relevance to date has been limited to the liberalization of the government procurement market.

Critical mass agreements (CMAs) constitute a negotiating technique to reduce the impact of free riding.<sup>13</sup> Unlike plurilaterals, they have no institutional underpinning in the Agreement establishing the WTO. In the negotiations that led to the advent of the Information Technology Agreement (ITA), for example, trading partners agreed that the eventual agreement would not enter into force unless a certain percentage of world production had first been covered. However, characterizing these initiatives as clubs is probably an exaggeration. CMAs have so far exhausted their usefulness in the negotiation of tariff reductions that have been multilateralized without non-participants being obliged to pay consideration.

## 2.5. Task Force Focus

To honour its mandate, the Task Force proceeded in two steps. Two meetings were organized with a select group of experts where regulatory cooperation/coherence was discussed in a horizontal manner. The Task Force also commissioned think pieces authored by group members on select issues that were considered to deserve additional in-depth discussion. The main arguments of the think pieces are presented in Box 1 below.

It was stated *supra* that the concepts of regulatory cooperation and coherence are amorphous. The Task Force privileged a bottom-up approach, since a top-down approach has innate limitations. Indeed, there is only so much one can do trying to define terms such as “regulatory cooperation,” precisely because its forms and variations can, in practice, be countless. Indeed, the OECD (2013) study referred to above, acknowledging this fact, refers to basic types of cooperation. Consequently, some aggregation is necessary for the discussion to be meaningful. Furthermore, top-down approaches are usually oblivious to the realist’s concerns. Realism is very much an issue in a policy-oriented endeavour.

The bottom-up approach had two legs. First, the business community and representatives of NGOs and international organizations were asked to come up with evidence where problems have arisen due to a lack of regulatory cooperation/coherence. This enquiry helped to better understand the problems posed by a lack of transparency, untimely cooperation, inadequate implementation and private standards. Second, representatives of the WTO and PTAs were invited to outline the current mandate for regulatory cooperation. Armed with this knowledge, a first shot was taken at the distance between the current and the desired level of cooperation. A select number of academics were then invited from various realms of expertise. This interaction allowed for a better feel regarding the original estimate of the distance, as well as a preliminary attempt at outlining recommendations.

### Box 1: Overview of E15 Think Pieces on Regulatory Systems Coherence

The selection of topics and authors responded to the need to blend into the process as much experience from ongoing regulatory cooperation as possible. The perspective is on trade, since the aim is to provide some input to the WTO regarding the manner in which it could better serve its current and anticipated workload. This trade perspective, however, is not exhausted within the confines of the current WTO mandate or regime. Indeed there are numerous initiatives (some of which are referred to above) focusing on regulatory cooperation that take place outside of the WTO, either formally within PTAs, or informally like the TACD. The think pieces cover a lot of this emerging picture.

It was also important to avoid “hothouse” analysis that might sound intellectually plausible but would stand no chance of implementation. The authors thus advanced options that could see the light of day without any need to move to a new multilateral institutional framework. All recommendations can take place within the current regime. With this in mind, we turn to a brief presentation of the think pieces.<sup>14</sup>

#### A. Arvius and Jachia: *Regulatory Cooperation: A Wikihow*

The authors provide a comprehensive presentation of different forms of regulatory cooperation and explain against this background the UN Economic Commission for Europe (UNECE) Recommendation L, which is a proposal for model regulatory cooperation. They also offer a case study to this effect.

<sup>12</sup> Hoekman and Mavroidis (2015), and Lawrence (2006) discuss the relevance of plurilateral agreements in negotiating arrangements aiming to discipline NTBs. By “Pareto-sanctioned” we understand that at least one party is better off as a result of the advent of the new agreement while no one’s situation has deteriorated.

<sup>13</sup> The free rider problem does not arise only in trade agreements. In 1931, seventeen nations signed the Convention for the Regulation of Whaling, which entered into force in 1935 (United States Treaties Series, 880). Seven more states adhered subsequently. Big whaling nations, like Germany and Japan, refused to sign the agreement. As a result, 43,000 whales were killed the year of the signature, with Germany and Japan able to profit from the lack of competition in this market. Today, the International Whaling Commission (IWC) has been in place since 1989 and counts 89 members. The free riding problem has substantially been reduced as a result.

<sup>14</sup> The think pieces are cited in the references and can be accessed at <http://e15initiative.org/publications/>.

The focal point in Recommendation L is the concept of common regulatory objectives (CROs). CROs will be jointly drafted by regulators in a given sector and will address legitimate objectives such as public health and safety, environmental protection, etc. CROs will be defined with reference to international standards, when applicable, and will also contain references on conformity assessment. Finally, CROs will include surveillance mechanisms to ensure that agreements have been implemented.

EU experts will unavoidably see similarities between the EU “new approach” to harmonization and Recommendation L. There is one crucial difference, however, that makes Recommendation L easier to implement in environments with heterogeneous players like the WTO: it is bottom-up and not top-down like the EU.

### **B. Bolyky:** *A Role for the World Trade Organization on Regulatory Coherence*

Bolyky focuses on the institutional arrangements that can best promote regulatory cooperation within the WTO. He outlines the case for variable geometry, arguing that there is a role for the WTO, even though (in the short run at least) most of the activity will take place within clubs.<sup>15</sup>

He then assesses the pros and cons of the three clubs that are possible within the WTO, namely critical mass agreements, plurilateral agreements and preferential trade agreements. He argues that plurilateral agreements and CMAs are preferable over PTAs, if we want, while promoting regulatory cooperation, to sustain a tight umbilical cord between clubs and the WTO. Plurilaterals and CMAs can be issue-specific (which may be necessary on occasion to promote regulatory cooperation); they can promote transparency to a greater extent than PTAs; they might lead to less trade diversion; and they maintain the link to dispute settlement under the WTO. Nevertheless, those who engage in regulatory cooperation within PTAs can probably achieve more by continuing down this path.

What is the role for the WTO in all of this? The WTO will monitor progress made in the clubs and will upgrade to the multilateral level the issues of cooperation that can be multilateralized. Thus, transparency in the short term might lead to legally binding agreements in the medium-to-long term, and the WTO will become the facilitator of the process and eventually the depositary institution for agreements.

### **C. Cattaneo:** *Promoting Greater Regulatory Coherence and Cooperation through Aid for Trade*

Cattaneo discusses Aid for Trade (Aft) and contemplates the manners in which this instrument can be used to promote regulatory cooperation.

The Aft initiative demonstrates a willingness to integrate laggards but a switch in focus may be warranted. In the author’s view, regulatory cooperation is important because of the ongoing “servicification” of manufacturing. Manufacturing is increasingly becoming global because of the emergence of global value chains (GVCs). Unavoidably, services inputs to manufacturing are becoming global as well. Services, however, are quite regulated and unless some cooperation is guaranteed the whole process risks being heavily burdened.

In order to facilitate cooperation, the distance between the “avant-garde” and laggards needs to be shortened. It is precisely in this context that Aft can be of help, were a change in focus agreed. Cattaneo suggests that Aft financing should privilege projects aiming to address, amongst others, competitiveness concerns within GVCs, investment, intellectual property, and the transfer of know-how.

### **D. Charnovitz:** *US Efforts to Ensure that Regulation Does Not Present Trade Barriers*

Charnovitz looks closely at the manner in which the US has promoted regulatory cooperation over the years. The most decisive initiatives are those that have been undertaken in the second term of the Obama administration. Mechanisms have been adopted that will enable the US to assess the impact of its measures on trade, and also to review (and hopefully, eliminate) measures that it deems unnecessary (e.g. excessively restrictive) in order to reach stated objectives. The US wishes to promote a similar culture/approach across its (major) trading partners.

The US has moved towards establishing a framework for intensive regulatory cooperation with Canada and Mexico, which is unsurprising as the neighbouring countries are NAFTA partners. The US is developing a comparable framework with its transatlantic partners. Some *de facto* business-to-business cooperation has been consolidated in the Transatlantic Business Council. Ties have been developed between civil societies in the framework of the Transatlantic Consumer Dialogue. And this is all happening while the TTIP has yet to see the light of day.

<sup>15</sup> This term variable geometry refers to an institutional setting where differentiated membership can participate in different agreements coming under the same roof. The EU offers a good example, where both the monetary union, as well as the enhanced cooperation, allows for a subset of the EU membership to go ahead and integrate in areas where other members might find it unwarranted.

### **E. Kauffmann and Malyshev:** *International Regulatory Cooperation: The Menu of Approaches*

This is the first of two papers prepared by members of the OECD Secretariat (the second, being the paper authored by van Tongeren et al. discussed below). This paper focuses on a typology of regulatory cooperation that has been developed by the OECD (2013), as well as a discussion of the expected benefits (whereas the paper by van Tongeren et al. focuses on trade costs stemming from a lack of cooperation).

The paper classifies eleven forms of cooperation ranging from the most stringent (integration/harmonization through supranational institutions, citing the EU) to informal exchanges of information (such as the Transatlantic Dialogue discussed above). Between these two extremes, they categorize the following: specific negotiated agreements (e.g. international treaties); formal regulatory cooperation partnerships (e.g. Canada-US Regulatory Cooperation Council); joint standard setting (OECD, WTO); trade agreements with regulatory provisions (e.g. modern PTAs); mutual recognition agreements; trans-governmental networks of regulators (e.g. International Laboratory Accreditation Corporation or ILAC, a forum that manages conformity assessment agreements signed by various accreditation bodies); unilateral convergence through good regulatory practices (e.g. TBT, Good Regulatory Practice); recognition and incorporation of international standards (e.g. ISO); and soft law principles and codes of conduct.

Gains from regulatory cooperation include not only economic gains but also mimicking better regulatory examples and capacity building. Countries willing to embark on this process will have to address domestic political economy concerns and be ready to face implementation costs. The choice of the intensity of cooperation will be function of a cost-benefit analysis.

### **F. Thorstensen, Weissinger and Sun:** *Private Standards: Implications for Trade, Development and Governance*

The paper discusses the problems posed by the emergence of private standards. Its focus is on warning about the dangers entailed in a lack of cooperation, as private standards are developed by few players, without much negotiation within the WTO. The emergence of global value chains has contributed to the proliferation of private standards, since they are an appropriate manner for the transnational corporations (TNCs) that dominate GVCs to discipline the supply of inputs.

Developing countries in particular face an uphill battle, as they are requested to comply with TNC standards that they do not have to observe in the WTO framework, which, in their view, provides some guarantees that their interests will be safeguarded. The authors thus see a role for the WTO in this realm. Specifically, they would like discussions on private standards to move away from the current “fragmented” framework (where discussions

take place in parallel in different WTO committees), and would further like the WTO to clarify the relevance of its own legal arsenal on private standards. They propose an elaborate five-step process that will enable stakeholders to reach a functional regulation of the issue. What matters is that participation in this process should not be solely reserved to the WTO, but opened to other institutions (such as the ISO) that have been active in the elaboration and adoption of standards.

### **G. van Tongeren, Bastien and von Lampe:** *International Regulatory Cooperation, a Trade-Facilitating Mechanism*

The authors approach the subject of regulatory cooperation as a sort of trade facilitation mechanism. In their view, the most promising type of cooperation should balance regulatory objectives with the means to achieve them and the impact on trade, with a combined positive net gain to society.

They identify three categories of trade costs that the international community should address and aim to reduce: information costs (obtaining information about regulations); specification costs (complying with regulatory standards in the export market); and conformity assessment costs (relating to a demonstration of compliance with standards).

They cite numerous empirical studies showing how cooperation mechanisms such as harmonization and/or recognition can increase trade and facilitate allocative efficiency. Nevertheless, unilateral evaluation of the trade impact of regulations is the first, necessary step. Regulatory cooperation should be undertaken in circumstances that trigger a positive net benefit where the costs of maintaining domestic regulations are high.

### **H. Wijkström:** *The Third Pillar: Behind the Scenes, WTO Committee Work Delivers*

The TBT Committee is widely hailed as an example of successful cooperation at the WTO. Wijkström lays out the terms of regulatory cooperation between WTO members in the TBT. The committee is a forum where both the regulatory and the trade communities meet and communicate. Many of the issues debated are of a technical nature and as a result it is quite often the case that both communities are simultaneously present in the room. They thus have the opportunity to understand each other's concerns. The regulatory community is sensitized to the trade impact of regulations, whereas the trade community has the opportunity to be exposed to the rationale for trade-impacting regulations. Private sector engagement is essential to this work.

Domestic coordination procedures (if effective) will ensure that the private sector—along with other stakeholders—exerts influence on positions taken at the WTO. Sometimes, because the composition of national delegations is the exclusive privilege of WTO members, it may be that the private sector (or other stakeholders)

is present through the delegation. The TBT Committee emerges as a genuine multilateral forum with 127 out of 161 WTO members having already notified and debated regulation under the aegis of the TBT Agreement. Pragmatism is the driving force of the TBT Committee: it does not issue legally binding documents and it does not have a specific mandate to resolve disputes with the WTO *imprimatur*. And yet it manages to agree on procedures and to significantly contribute to the understanding of national policies (and thus, set aside potential disputes). Currently, WTO members continue to work on guidance aimed at avoiding unnecessary obstacles to trade; referred to as Good Regulatory Practice (see above).

#### I. **Wolfe:** *How Can We Know (More) About the Trade Effects of Regulation?*

Wolfe insists on the role that transparency is called to play. He does not deny that substantial progress has been made at the WTO on this score, but argues that there is still much room for improvement. He prioritizes improvements in two areas:

- He underscores that the measurement of trade effects of regulation is an area of revealed interest for WTO members. Otherwise, why include the legal discipline on necessity? And yet, the “culture” of measurement has not made much headway. Panels for a start, by understanding the obligations assumed as guarantee for equality of competitive conditions in the future, have stopped short from using “trade effects” as a proxy to decide whether non-discrimination (the basic GATT/WTO discipline) has been adhered to. Wolfe points to sector-specific work that has been done outside the WTO, which could be of relevance. He cites, for example, the OECD Services Trade Restrictiveness Index, which estimates the effects of regulation on trade in services.
- He revisits previous work on transparency, which led many to conclude that WTO members often lack the incentives to be transparent as they may be offering private and self-incriminating information. He thus sees more of a role for the WTO Secretariat, the “common agent.” This could be done through several existing mechanisms (e.g. the Trade Policy Review Mechanism), but new initiatives could also be designed. An obvious starting point is transparency regarding regulatory activity within PTAs. A lot is happening, as discussed *supra*, and there is at best uncertainty regarding what they should be reporting following multilateral review of notified PTAs by WTO bodies.

# 3. Policy Options: From Current to Desired Cooperation

The policy options recommended in this paper aim to cover (as much as possible of) the distance between the current level of cooperation at the WTO-level and at the PTA-level, and the desired level of regulatory cooperation.

As can be seen from the discussion so far, the paper (and the process behind its deliberations and conclusions) aims to bring together two communities that (alas) are not in close communication—namely, the trade and regulatory communities. In principle, the former cares about addressing trade barriers, whereas the latter does not have trade in mind when evaluating appropriate responses to address distortions. And yet, the distinction between “domestic” and “trade” concerns seems increasingly artificial. The liberalization of investment, cross-border vertical integration, and the emergence of global value chains have contributed towards shortening the distance between the two communities. Some noteworthy initiatives by the US Obama administration are evidence of this trend, and we will return to this issue in what follows.

It should be underscored upfront that the objective is to design solutions that can find application across the board, and not simply between a set of homogeneous players. Ideally, the WTO should try to accommodate both multilateral and plurilateral deals among a subset of its membership. However, the old “battle of –isms” should not be renewed, where multilateralism was idolized and regionalism was demonized. Over 500 FTAs later, those who fought this battle should be conceding defeat, at least as far as pragmatic trade cooperation is concerned.

This is not to say that PTAs (and clubs in general) do not give rise to (new) issues to tackle. In a world where tariffs are becoming irrelevant, and it is regulatory barriers that segment markets, the problems are of a different, milder order. After all, regulation must observe the TBT and SPS disciplines discussed above, and among them non-discrimination. Clubs are facilitating deals between those willing to commit. Outsiders (who are WTO members) can live in the safety (to the extent that it is state behaviour that is being disciplined) that they can access clubs on conditions that are identical to those the original insiders had to observe.

Homogeneity of participants is a contributing factor towards ensuring regulatory cooperation. This is why the most far-reaching schemes of regulatory cooperation that we observe—either formal (e.g. RCC) or informal (e.g. TABD)—are between homogeneous players. A key challenge for the multilateral trading system will be to ensure that

such schemes keep the WTO umbilical cord intact while introducing mechanisms that will facilitate an eventual multilateralization of effective regulatory cooperation within clubs. We will return to this issue *infra*.

As stated, since this is a policy exercise, proposals must exhibit a substantial dose of realism. There is often a trade-off between selection of the first best instrument and realism, in that first best instruments could be costly or simply politically undesirable. The recommendations seek to walk along this tightrope without sacrificing too much in either direction.

With this in mind, the recommendations are divided into “institutional” and “substantive” categories. The former are dedicated to issues regarding who participates in the discussion, under what conditions, etc. The latter focus on a selection of issues that have captured the minds and attention of the trade and regulatory communities. They concern the improvement of existing obligations and mechanisms for regulatory cooperation.

## 3.1. Institutional Recommendations

### 3.1.1. Clubs

The single undertaking framework has been applied with considerable success during the Uruguay Round but not so during the Doha Round. Clubs are becoming inevitable.

The GATT was successful in dismantling tariff barriers, with a number of exceptions still in place. The WTO has since managed to complete one additional tariff agreement (the ITA, the second version of which was reached in July 2015). It has also concluded two agreements: one dealing with deadweight loss (the Trade Facilitation Agreement) and the other with trade and development (Aid for Trade). However, it has so far proven impossible to conclude multilateral agreements on “pure” regulatory issues. Meanwhile, agreements covering regulatory matters are routinely negotiated between subgroups of the WTO membership, overwhelmingly in the context of PTAs. Since it is regulatory barriers that segment markets today, recourse to this type of arrangement will, in all likelihood, not diminish.

As noted, we observe at an empirical level intense regulatory cooperation mainly among like-minded players. This should not come as surprise. WTO membership resembles the United Nations; it is composed of different players with different social preferences drawn from different cultural backgrounds and different levels of development. This amalgamation of participants who do not share the same concerns or priorities makes consensus difficult to achieve.

The WTO should rethink its attitude towards variable geometry. The promotion of PAs and CMAs (ahead of PTAs) should figure high on the agenda. At the same time, some form of cooperation (in terms of consultation and transparency for example) should continue to take place on a multilateral basis.

The contribution of PAs could be meaningful in the regulatory arena. It would appear that fewer concerns are raised by PAs dealing with new issues than subjects that are already covered by the WTO. The Government Procurement Agreement (GPA) remained a PA after the Uruguay Round because procurement is explicitly excluded from the reach of Article III of GATT (national treatment) and Article XIII.1 of GATS—although, in contrast to the GATT, GATS calls for negotiations on the procurement of services to be launched two years after entry into force of the agreement (i.e. 1997).

The GPA precedent suggests that one rationale or function of PAs could be as an instrument to allow WTO members to deal with issues that are not (yet) covered by the WTO—any disciplines that are agreed among a subset of countries will not undercut existing commitments as there are none. Article III.8 of GATT explicitly excludes government procurement from the obligation to observe national treatment. By signing the GPA and agreeing to national treatment between them, a few WTO members moved into an area not covered by the WTO mandate. In a similar vein, one could imagine PAs in the area of investment protection, coordination of monetary policies, etc. PAs could of course also be signed in areas already covered by the WTO mandate should a few members wish to move further and faster. An example is the recent suggestion by some countries to negotiate PAs on services or on trade facilitation.

The possibilities on the regulatory front are endless. The WTO is a negative integration regime, where domestic policies are designed unilaterally and must be applied in a non-discriminatory manner. There is thus the potential for cooperation among like-minded countries in various areas, while keeping the door open to future accessions.

One more issue is worth mentioning here. From a WTO (multilateral) perspective, there is an obvious advantage when recourse is made to PAs as opposed to PTAs. Hoekman and Mavroidis (2015) advance a series of arguments explaining why PAs keep the umbilical cord to the multilateral system tight. Since, for the reasons outlined above, recourse to clubs is necessary in order to dismantle regulatory barriers, it is in the interest of the WTO to monitor what is happening within this realm. Monitoring will be facilitated if PAs are preferred over PTAs.

The WTO should become some sort of “osmosis mechanism” that will select the issues or agreements at the plurilateral level that could be multilateralized.

**Policy Option 1:** The WTO should actively promote regulatory cooperation within clubs and develop mechanisms that enable the multilateralization of clubs-only agreements. In this respect, the establishment of PAs should be sanctioned unless WTO members representing a combined threshold of world trade (e.g. 20%) block it. The WTO should particularly encourage PAs that deal with issues that do not come under the existing mandate.

### 3.1.2. Easier access for business

A consistent grievance expressed by business is that it does not have easy access to the various WTO committees. Its concerns are not heard and as a result policies that are supposed to regulate business behaviour are designed without any input from the most interested stakeholder.

The access of business to the WTO is of course a function of the persuasive power of lobbies, since lobbies must convince their national governments about the legitimacy of their concerns. They can participate in WTO deliberations only through them, as the WTO is a state-to-state contract. For some business interests of a transnational nature and they might find it even harder to persuade one specific government.

In EC-Bananas III, the Appellate Body held that WTO members could choose the composition of their delegation. Thus, in principle it is up to individual WTO members to decide whether they want to give voice to business concerns. This has proven to be manifestly inadequate. The WTO should take the initiative of inviting business interests to participate when regulatory issues of concern to their operations are being addressed. Transnational business interests can prove to be an ally to the WTO in its quest to combat unnecessary, excessive regulation. The easiest way to achieve this is through an extension of the observer status to business representatives.

It is true that business participation is asymmetric across the various WTO committees. This is a function of various factors ranging from business interest in the work of a particular committee to government (un)willingness to reveal its preferences. It is also true that the TBT and SPS Committees rank among the WTO committees with the most intense participation of business representatives. The efforts of these two committees should be commended and improved. The continued relevance of the WTO in trade matters also hinges on its relevance to business interests.

**Policy Option 2:** Business interests should be in a position to continue voicing their concerns, especially in the TBT and SPS Committees, where they should participate as observers. Their participation should be encouraged and requests for observer status should not be refused except for compelling reasons to be agreed and transparently communicated. In designing this observer status, the WTO could be inspired by the “Industry Advisory Committee” of the OECD or the “Business Advisory Council” of APEC. Participation of business interests should not be confined to areas covered by the TBT and SPS Agreements. It should occur in all areas coming under the aegis of the WTO, with priority given to services trade. A “Business Advisory Council” in the WTO could usefully see the light of day in this context.

## 3.2. Substantive Recommendations

### 3.2.1. Transparency

Transparency obligations in the TBT and SPS Agreements are the most far-reaching in the WTO regime. One-stop shops, enquiry points, intervals between the preparation and adoption of measures coming under the aegis of the two agreements constitute important innovations. Regulation, however, extends to areas not covered by the TBT and SPS Agreements, and the first substantive recommendation would be to consolidate all such innovations in one new provision (or agreement) on transparency.

The TBT Information Management System informs that 19,723 notifications of measures had been recorded at the time of writing. The number is impressive, and yet the discussions and think pieces behind this paper lead to the conclusion that improvements are still possible.

Transparency alone is a factor that decisively contributes to reducing the magnitude of trade friction. Take for example the case of specific trade concerns mentioned in introduction. According to the official WTO website, 460 STCs had been raised by July 2015. A healthy percentage (more than one-fifth of the total) concerned requests for clarifications regarding national measures. The fact that a very small percentage of STCs have become formal disputes (five cases can qualify as quintessentially TBT disputes) suggests that additional transparency has helped remove concerns regarding the function of national TBT measures.

There are three areas where improvements to the current transparency obligation can be achieved. First, what should the membership be transparent about? Second, when should the transparency obligation kick in? Third, how much information should be provided?

Transparency should cover projects of laws, final measures and amended measures. Information should also be provided on alternatives that could usefully help regulators reach the stated outcome, as well as on the trade impact of the adopted measure. Regulators should explain alternatives that they have (eventually) dismissed, but they should also be prepared to hear about the efficacy of alternative measures that they had not contemplated and explain why they might consider them inappropriate for use in their country.

There is a very important first step here. Often we do not know where the problems lie. Hence, a natural preliminary stage would be for regulation to be transparent. And, of course, part of this discussion concerns a mapping of the current situation. There is sometimes a lack of knowledge regarding the regulatory process of even the most advanced democracies that are WTO members. There are often unused opportunities and a lack of information regarding national transparency mechanisms.

This is an area where work could usefully be done working from both sides of the equation: the supply and demand of information. The idea would be to map the overlap and assess what can be done with respect to whatever is left out.

Business consistently complains about “unhelpful” transparency—e.g. the notification of measures that have already entered into force. Coglianese (2009) usefully distinguishes between “fishbowl” and “reasoned” transparency. The first term focuses on the release of information that can document how government officials actually behave, such as by disclosing meetings. But there is another type of transparency, reasoned transparency, which demands that government officials offer explicit explanations for their actions. Sound explanations will be based on the application of normative principles to the facts and evidence accumulated by decision-makers, and will show why an alternative course of action may have been rejected. It is the latter form of transparency that could be helpful to address business industry concerns.

There is an additional element to consider: the outcome is (largely) influenced by political economy, especially in democracies. Absent internationalized investment, lobbies represent domestic players only. If transparency comes at a stage when everything has been decided, then foreign interests will simply not be taken into account.

The involvement of affected parties at an early stage, coupled with an obligation to explain national measures, are important improvements to a mere obligation to sterile transparency, which is usually exhausted in the requirement to publish laws and/or notify them at the WTO.

There is a very important twist here. “Affected parties” should not be understood as only the business community. It is important to recall that two communities need to come together in the process: the trade and regulatory communities. Regulation affects citizens at large. Its spokesperson is civil society in its various shapes and forms. Transparency should be all-inclusive; it should aim to implicate all interested stakeholders in the process. This obviously takes, properly speaking, an internal and not an international trade dimension. It is nonetheless a step that we recommend since it is by all means appropriate and it will have a positive effect on discussions related to trade. The trade dimension of regulations will be de-mystified and trade sceptics will understand that the influence the WTO regime exercises on domestic regulatory processes is both measured and heading in the right direction.

To some extent, the current regime does address these concerns. First, according to the existing TBT Agreement, all WTO members must guarantee an interval between publication and entry into force. There are complaints, nonetheless, that this is not fully observed. Second, the TBT Committee has been quite active in proposing initiatives such as the guidelines for Good Regulatory Practice aiming to improve the quality of regulatory interventions among WTO members. Similar initiatives should be encouraged. More specifically, to ensure that sufficient time is allocated to foreign interests to adjust to new realities, the use of one-stop shops should be encouraged. Traders should not spend time gathering information about the place where information will be provided. Furthermore, the interval between publication and entry into force should not be unduly restrictive.

Another way to improve the current system is to oblige regulators to follow certain procedural steps before measures enter into force. Specifically, these would include the obligation to provide: the rationale for intervention (reasoned as opposed to fishbowl transparency); a preliminary assessment of the expected trade impact of proposed measures (this will result in closer interaction between the regulatory and trade communities of the intervening WTO member—US practice in this area could serve as benchmark); written explanation as to how alternative measures were taken into consideration before selecting the proposed method; and responses to questions raised by interested parties (while allowing civil society, the business community and WTO members to act as observers with the possibility to enquire).

**Policy Option 3:** The current transparency obligation must be consolidated and further strengthened in five directions: (i) there should be a “mapping” of national mechanisms that are intended to provide transparency with respect to national regulatory processes; (ii) WTO members should notify all adopted measures, whether based on international standards or not; (iii) they should explain the rationale behind their measures (“reasoned transparency”); (iv) they should involve affected parties at an early stage in the process; (v) they should use the reasonable interval between publication and entry into force of a measure to fine-tune regulation so that it represents a balanced trade-off between genuine regulatory concerns and an effort to minimize the resulting trade impact. It bears repetition that this proposal is not limited to trade in goods.

### 3.2.2. Assessing the trade impact of regulations

*Ex ante* assessment of the trade impact of regulation is a helpful, and very noteworthy, accomplishment of the Obama administration. It is not unheard of, however, that such assessments may overestimate or underestimate certain correlations with other factors that also influence the trade outcome. It is thus always useful to accompany these exercises with an *ex post* assessment of the trade impact of a measure.

The initiative to conduct *ex post* assessments should not be entrusted (at least not exclusively) to the original regulator (the same could also be said for the *ex ante* assessment). The idea would be to produce credible evidence regarding the operation of the measure that is being assessed. Stakeholders could then compare original expectations with actual practice. This type of information could provide a

useful input not only to redesign (if needed) the concerned measure, it could also be valuable for similar future measures, as stakeholders would be in better position to evaluate their operation.

This recommendation might prove to be an uphill battle for developing countries with limited administrative capacities. To overcome this hurdle, the more advanced bureaucracies should be prepared to share their experiences and engage in training and capacity building. This is where existing WTO mechanisms such as the Aft initiative can contribute towards enhancing the level of regulatory dialogue between WTO members.

**Policy Option 4:** The original *ex ante* assessment of the impact of a proposed regulation should be accompanied by an *ex post* assessment of the trade impact of adopted measures. To the extent that discrepancies between the expected outcome and the observed impact exist, national administrations could revise their *a priori* assumptions so as to design more efficient regulations in the future.

### 3.2.3. Encourage the implementation of international standards

The preceding discussion has established that transparency emerges as a key issue. Notwithstanding the high number of notifications, WTO members might not always have an incentive to be transparent about their policies. Standard-setting organizations (SSOs) have the opposite incentive, i.e. to be transparent. Indeed, by construct, the credibility of institutions in setting “world” standards heavily relies on their “inclusivity” and the power of persuasion that they indeed design standards for the world. Moreover, from a purely legal perspective, unless they are all-inclusive their output will not be recognized by the WTO.<sup>16</sup> The adoption of international standards will thus contribute to transparency.

Transparency is obviously not the only reason why the use of international standards should be encouraged. As mentioned, regulatory diversity is in and of itself a market segmentation factor. This paper evidently does not argue for a totally deregulated world in order to promote trade liberalization. Regulation solves problems; and the manner in which various problems are solved not only differs, but may also need to differ in light of the differentiated conditions that exist around the world. A country with a well-funded and professional regulatory apparatus may be in a position to tackle problems that another country simply cannot remedy. Furthermore, societies have distinct values, preferences and

<sup>16</sup> In 2000, the TBT Committee adopted a decision to this effect (G/TBT/9, of 13 November 2000). The Appellate Body has recognized in its report on US-Tuna II (Mexico) the legal relevance of this decision, holding that it is a subsequent agreement in the Vienna Convention sense of the term, which practically means that judges must refer to it when deciding whether a standard is “international,” and hence recourse to it is in principle compulsory as per Art. 2.4 TBT (§372). The Decision’s §7 is entitled “Openness” and reads:

Any interested member of the international standardizing body, including especially developing country members, with an interest in a specific standardization activity should be provided with meaningful opportunities to participate at all stages of standard development. It is noted that with respect to standardizing bodies within the territory of a WTO Member that have accepted the Code of Good Practice for the Preparation, Adoption and Application of Standards by Standardizing Bodies (Annex 3 of the TBT Agreement) participation in a particular international standardization activity takes place, wherever possible, through one delegation representing all standardizing bodies in the territory that have adopted, or expected to adopt, standards for the subject-matter to which the international standardization activity relates. This is illustrative of the importance of participation in the international standardizing process accommodating all relevant interests.

fears, all of which can lead to diverse regulatory approaches to address similar concerns. It is thus not only political economy but also the public interest that drives regulation across sovereignties in different parts of the world.

International standards offer a process where the influence of (domestic) political economy, while respecting different values, can be tamed. Thus, transaction costs are reduced between those subscribing to the same standard.<sup>17</sup>

Current TBT and SPS disciplines require recourse to standards to the extent that they are appropriate in light of the objective pursued by WTO members. There is room for improvement in two respects.

First, the notion of “international standard” should be clarified. The TBT Agreement mentions only in passing the ISO (one of the SSOs). Even the SPS Agreement—which does mention three SSOs whose output can be equated to “international standards”—contains an indicative list of SSOs, leaving it to the panels to decide on this issue. The 2000 Decision is a step in the right direction, but probably not a sufficient one, since it leaves a lot of room for discretion on the part of panels to decide whether a standard is international. Were one to take into account the institutional design of these panels (in the majority of cases composed of non-experts in this specific area), it becomes obvious that there is a strong argument in favour of limiting discretion upfront. To this effect, an indicative list of SSOs would be helpful.

Second, the allocation of the burden (production) of proof as decided by the Appellate Body in *EC-Sardines* might act as an incentive to neglect international standards where they could have been appropriately used. In this case, the WTO organ decided that plaintiffs carry the burden to demonstrate that a national measure is consistent with an international standard, irrespective of whether the regulating WTO member has deviated from an international standard or not.<sup>18</sup> This case law has been reproduced *verbatim* in all subsequent cases. Various authors have criticized this approach on different grounds. Of interest to the present discussion is the following: a reversal of case law will contribute towards the increased use of international standards, since those willing to deviate will have to be prepared to carry the associated burden of proof.

Finally, this point should not be understood as the endorsement of a race for the full harmonization of all preferences, far from it. Harmonization makes sense under a particular set of conditions—e.g. the presence of network externalities (when the value of a product or service is dependent on the number of persons using it). It would of course be far more preferable to strive for other integration instruments such as recognition. Recommendation L that we have detailed *supra* could be of relevance in this context and could enable cooperation at larger scale. As

stated, however, such instruments require trust with regards future activities, which is hard to imagine between unlike players. Harmonization, on the other hand, requires the implementation of agreed norms, nothing more.

Further, harmonization should be expected to occur where gains from cooperation are clear and present. After all, it is private operators that drive much of the process behind the best known and established SSOs.

**Policy Option 5:** Article 2.4 of TBT (and article 3.1 of SPS) could be further strengthened. Besides encouraging the use of international standards in principle, it could make it clear that deviations from international standards should be justified by the deviating state. The same provision(s) should be enriched in two ways: through an explicit reference of the 2000 Decision and through the addition of an indicative list of SSOs.

### 3.2.4. Private standards

Private standards have mushroomed over recent years. We live in a world full of standards but not in a standardized world. For developing countries, which are typically “takers” of standards, this phenomenon has added to existing transaction costs. Furthermore, they represent an increasingly important hindrance for those willing to jump on the bandwagon of GVCs.

As things stand, there is a very high degree of uncertainty as to whether private standards are disciplined by the WTO. And the fact that (complaints notwithstanding) no one has yet to initiate a dispute on this score is the best proof that the common view is that they lie outside the perimeters of the organization. A series of discussions have taken place in the TBT and SPS Committees, with members unable to bridge their differences.

Those who pay the price regarding the proliferation of private standards would like to see some harmonized solution to the issue, with the WTO emerging as a natural forum. Otherwise, it is asymmetric national laws that apply, which could (or could not) provide for transparency, effective consumer protection, antitrust liability, and so on.

**Policy Option 6:** The WTO should concentrate on private standards by dedicating one forum to address the issue. The WTO could be inspired by prior endeavours, such as the 1971 Working Party on Border Tax Adjustments, which was established to clarify GATT law with respect to taxes that could lawfully be adjusted in a trade transaction. Instead of continuing along the current top-down approach (i.e. what is a private standard?), which has so far led nowhere, it would probably be more opportune to dedicate to sector-specific negotiations and try to extrapolate elements from prior successful experience to the new sectors under discussion.

<sup>17</sup> National regulations must be *based* on international standards. In its very recent report on India-Agricultural Products, the Appellate Body held that this wording allows for some discretion by implementing national authorities, which, nevertheless, cannot put into question the quintessential elements of international standards.

<sup>18</sup> In presence of an international standard, the European Union (defendant) had decided to adopt its own measure, which was not consistent with the international standard. The question that arose was who should justify the deviation? Against all odds, the Appellate Body decided that it should be Peru, the complaining party, and not the defendant. The Appellate Body did not even pay lip service to the fact that it could be for reasons of private information that the defendant had decided to deviate. It held that the various transparency requirements embedded in the TBT Agreement allowed Peru to have a good idea about the reasons for deviation, and allocated the burden of proof accordingly.

# 4. Final Remarks and Next Steps

A very appropriate way to rationalize the quality of regulatory interventions at home is by looking at the best examples elsewhere and mimic them. Increased transparency at the WTO in the manner presented in this paper will be a decisive step in this direction. Reasoned transparency, as described above, should become a priority for the WTO. It is through this mechanism that the trade and the regulatory community will be brought around the same table. Bringing these two communities under one roof should become one of the WTO pillars as the organization continues to strive towards integrating markets predominantly segmented through non-tariff barriers.

What should be the next steps in this endeavour? We have stated early on in this study that all our proposals are armed with a heavy dose of realism. Viewed from this perspective, it would not matter if we started from Policy Option 2 or 6. What we would not like to see, though, is the forest sacrificed for the tree. To be clear, we would like to see an institutional innovation that would promote regulatory cooperation across the WTO membership on a sustainable basis. “Functionalist” approaches have worked well in various fora, and it is for this reason that we encourage the current initiatives undertaken in the context of the TBT and SPS Committees. There is no reason, nevertheless, to restrict such initiatives to issues covered only by the TBT and SPS Agreements. They should be reproduced elsewhere, and they should also be improved.

Alternatively, the WTO could envisage establishing a Working Group on Transparency where all our proposals could find a home for debate and deliberation. Every once in a while, economists point to new gains from market integration. For the world community to reap these gains it needs to understand the reasons for intervention in the first place, evaluate the different attempts to regulate comparable or even similar issues, and promote the most efficient solutions. Membership in this endeavour may vary depending on various factors. The WTO should provide the common roof. It should add a function akin to an Information Exchange regime before designing new disciplines on non-tariff barriers.

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The papers commissioned for the E15 Task Force on Regulatory Systems Coherence can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	The Current Situation	What Needs to Change
<b>Institutional Recommendations</b>		
<p><b>1. The WTO should promote recourse to plurilateral agreements, especially in areas of regulatory cooperation not covered by the current WTO mandate.</b></p> <p>It should increase the flow of transparency from clubs (PAs, PTAs) to the WTO.</p>	<p>Article X.9 of the Agreement establishing the WTO requires consensus voting by the WTO membership for a PA to be added to the WTO legal arsenal.</p>	<p>The provision needs to change in two respects:</p> <ol style="list-style-type: none"> <li>1) Instead of consensus, PAs should be added unless WTO members representing 20% of world trade opposes them</li> <li>2) An encouragement should be added that PAs focus on areas not covered by the current WTO mandate, e.g. investment protection, trade facilitation for services, etc.</li> </ol>
<p><b>2. The WTO should open up to business interests, especially to transnational business that might find it hard to press its views through one WTO member.</b></p>	<p>Nothing in the current legal design stops WTO members from adding business representatives to their delegation. Nothing, however, guarantees that business interests will be represented either.</p>	<p>The Industry Advisory Committee of the OECD and the Business Advisory Council of APEC can provide the blueprint for a WTO opening to representation of business interests to the various WTO committees.</p> <p>Participation of business interests should not be confined to areas covered by the TBT and SPS Agreements.</p>
<b>Substantive Recommendations</b>		
<p><b>3. Transparency disciplines must be strengthened and consolidated.</b></p>	<p>Transparency is discussed in various agreements in a scattered manner. It requires publication of measures coming under the agreement at hand, interval between adoption and entry into force of measures (under the aegis of the TBT and SPS), and enquiry points where explanations regarding national measures will be provided.</p>	<ol style="list-style-type: none"> <li>1) Transparency-related obligations should be consolidated in one agreement.</li> <li>2) WTO members should be required to provide <i>ex ante</i> evaluations of the trade impact of their regulation, and observe “reasoned transparency” – i.e. provide explanations about measures to be adopted.</li> <li>3) Both business interests and civil society at large should be implicated early on in the process, before final decisions have been taken.</li> <li>4) The aim of transparency should be to bring together the regulatory and the trade community.</li> </ol>
<p><b>4. WTO members should be required to perform <i>ex post</i> evaluations of the trade impact of measures adopted, and make the necessary adjustments when warranted.</b></p>	<p>There is nothing to this effect in the current agreements coming under the aegis of the WTO.</p>	<p>A new provision to this effect needs to be introduced.</p>

Policy Option	The Current Situation	What Needs to Change
5. Recourse to international standards should be encouraged.	Article 2.4 of TBT and Article 3.1 of SPS request from WTO members to base their measures on international standards, when appropriate.	<p>The two provisions should be modified so as to:</p> <ol style="list-style-type: none"> <li>1) Oblige WTO members to also notify their measures based on international standards;</li> <li>2) In case of deviation from an international standard, it is the deviating WTO member that should carry the burden of proof for doing so;</li> <li>3) The 2000 Decision should be added to the two agreements and should be observed by WTO members;</li> <li>4) An indicative list of SSOs should be added.</li> </ol>
6. The relevance of the WTO on private standards should be clarified.	There is an ongoing discussion regarding private standards that has led nowhere.	<p>The WTO should establish a forum with immediate effect (such as the Working Party on Border Tax Adjustments) that will clarify the legal relevance of the WTO TBT/SPS Agreements on private standards. Ideally, private standards should come under the aegis of the two agreements.</p> <p>Instead of continuing along the current top-down approach, it would be more opportune to focus on sector-specific negotiations and try to extrapolate elements from prior successful experiences to the new sectors under discussion.</p>

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# Rethinking Services in a Changing World

Policy Options Paper



The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND  
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# Rethinking Services in a Changing World

Patrick Low  
on behalf of the E15 Expert Group on Services

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Services. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Patrick Low was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced below.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

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# Abstract

Services have needed rethinking for a long time in a changing world. The role of services in production, consumption, and trade has evolved dramatically in the last few decades. Information-related and transport technologies have splintered production locationally and facilitated the separation of production and consumption over greater distances. At the same time, they have greatly shrunk space and time, providing a platform for the explosive growth of international trade and investment. By taking advantage of recently available data sets measuring trade in value-added instead of in gross terms, valuable new insights have emerged on the multiplicity of services entering trade and on the networked nature of economies. The world of policy has been trying to catch up with the evolution of services and servicification in the global economy where services are increasingly recognized as a prominent source of value creation, employment and growth. However, questions arise about the adequacy of arrangements for cooperation in this domain, and, in particular, whether the General

Agreement on Trade in Services (GATS) and preferential services agreements are fit for purpose. Following analysis of the background and dynamics to international cooperation in services, the present paper examines issues and outlines related recommendations under six specific categories: services and digitization; small and medium-sized enterprises and services trade; the role of “soft law” in international agreements; regulatory cooperation; coherence issues arising in relation to the separate rules governing goods and services; and, modifications to the GATS related to temporary presence and also scheduling disciplines. Twelve policy options are put forward for government action to develop an international services regime that addresses today’s economic and regulatory challenges, while fostering international cooperation and competition. Their unifying characteristic is that they are all recommendations that could change the framework for future trade policies and negotiations.

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Abbreviations	
APEC	Asia-Pacific Economic Cooperation
API	application program interface
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment treaty
CFTA	Continental Free Trade Area
CPC	Central Product Classification
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GVC	global value chain
HS	Harmonized System
ICT	information and communications technology
ITA	Information Technology Agreement
MFN	most favoured nation
OECD	Organisation for Economic Co-operation and Development
PTA	preferential trade agreement
RCEP	Regional Comprehensive Economic Partnership
RTA	regional trade agreement
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TFA	Trade Facilitation Agreement
TFTA	Tripartite Free Trade Area
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TPRM	Trade Policy Review Mechanism
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

# Executive Summary

Technology, the growing “servicification” of production, and increased trade dependency, accompanied by income growth associated with economic development and increased productivity, have all combined to make services an ever larger part of global economic activity. Yet for historical reasons services have been neglected both in academic work and policy discourse. This neglect has not only meant that the value contribution of services has been understated, but the various functions of services in production, trade and consumption have also been overlooked, along with the contribution of services to innovation and productivity growth. The invisibility of services and some of the ways in which they are produced and consumed have added a layer of complexity, and contributed to a paucity of data on services.

The unabated evolution of technology and international markets requires national policy-makers to rethink approaches to services in the context of trade competitiveness. National economies cannot function without access to competitive global networked services and trading platforms, all of which are powered and supported by trade in services—including computer, internet and digital services, telecoms services, delivery services, and financial services.

Against this backdrop, the E15 Expert Group on Services, convened by ICTSD in partnership with the World Economic Forum and supported by Sweden’s National Board of Trade, has engaged in critical analysis and forward-thinking on issues relating to a deeper and more comprehensive regime for services in the global economy. The experts explored new thinking and put forward fresh ideas on opportunities for reform and reinvigoration of international services regimes, especially at the multilateral level. The Group has striven to arrive at a set of viable and pragmatic policy options for trade officials, trade policy-makers and other stakeholders to consider, including for the WTO post-Nairobi agenda.

Policy-makers will benefit from the paper’s compilation of ideas and information for rethinking services trade in the context of today’s global economy. A broad array of topics is presented, concerning governments at all levels of development, from the digitized economy to regulatory cooperation in the evolving architecture for international trade in services.

## Background

The paper confirms that much more work is required in the area of trade in services, and suggests paths forward to address services at a multilateral and plurilateral level that may incubate new disciplines and approaches to negotiations.

By taking advantage of recently available data sets measuring trade in value-added instead of in gross terms, valuable new insights have emerged on the multiplicity of services entering trade. Much of this services-generated value addition tended to be mis-specified as value attributable to goods or misclassified within the services sector when data were only presented in gross terms.

It was not until the 1980s that serious systematic consideration was given to the institutional setting for international cooperation in services. This started in a multilateral setting and eventually resulted in the establishment of the General Agreement on Trade in Services (GATS). The GATS has been progressively complemented by preferential trade agreements (PTAs) in services, some of which have innovated with interesting variations on the currently prevailing structure of GATS schedules. The PTAs have often gone further in market opening than the GATS. This has not always been the case, however, as in certain instances PTAs have subtracted from GATS commitments. In many ways, refining international treaty frameworks—in the goods realm as well as services—and ensuring that they are relevant in a rapidly changing economic and business landscape will always be a work in progress.

The Doha Round negotiations in services have not progressed significantly, not least because some members have traded off a lack of what they regard as progress elsewhere with any effort to address a services agenda. This has resulted in the TiSA negotiations, which are currently taking place outside the WTO among countries that represent 70% of world trade. The systemic consequences of this unprecedented development, in terms of size and scope, remain uncertain and opinion is divided among observers as to how TiSA should be viewed. The final verdict will depend to a degree where the results ultimately sit in relation to the GATS and the multilateral framework.

## Policy Options

The Expert Group decided to focus particularly on a set of issues for which it commissioned think pieces by authors from within the Group. These were on services and digitization, small and medium-sized enterprises and services trade, the role of “soft law” in international agreements, regulatory cooperation, and coherence issues arising in relation to the separate rules governing goods and services. These papers were discussed by the Group and policy recommendations developed in relation to the written analysis and the discussion of it.

In addition, the Expert Group engaged in detailed discussions on temporary access of people supplying services in host markets, scheduling techniques for recording specific commitments on market access and national treatment, the use of standardized nomenclatures for recording commitments and approaches to addressing the gap between what governments commit to with their trading partners and what policies they actually pursue in practice. Each of these areas is also subject to policy recommendations.

Twelve policy options related the above issues are put forward for government action to develop an international services regime that addresses today’s economic and regulatory challenges, while fostering international cooperation and competition. Some of these options may seem rather technical in nature, when gauged against the need for a comprehensive response to the huge changes that are taking place in the global economy. However, their unifying characteristic is that they are all recommendations that could change the framework for future trade policies and negotiations.

## Next Steps

The options are presented over an indicative time horizon. Short-term options are mostly related to analytical and exploratory work that can be undertaken immediately whereas longer-term options are of more substantive nature and might require significant effort and consensus building. The task facing governments and other stakeholders is to find ways of rendering regimes for the regulation of services as relevant and supportive as possible to the challenges facing the global economy. Such arrangements must be equitable to gain acceptance, and contribute to sustainability, development and growth.

# 1. Introduction: What is this report about?

Services play an increasingly important role in the global economy. Propelled in no small measure by technological developments in information and communications technology (ICT), their contribution to value continues to grow alongside the internationalization of economic activity and rising global income. Services play a multifunctional role in production, trade and consumption. The complexities that underlie the role of services, linkages between services and goods, and economic outcomes are often not fully understood.

Mounting awareness of the evolving importance of services in the global economy has focused attention on the need for international cooperation to develop compatible and mutually advantageous agreements on services. Yet international regime building has been relatively slow, incomplete, and fragmented.

At the multilateral level, the General Agreement on Trade in Services (GATS) was negotiated in the Uruguay Round of multilateral trade negotiations (1986-1994) and came into force in 1995. The Agreement identified areas for further rule-making negotiations, including on the question of safeguards, subsidies, procurement and domestic regulation. This remains the case today with no tangible results in any of them. The multilateral regime currently governing services trade predates the digital revolution. Not surprisingly, many suggestions have been made on how to improve and adapt the GATS to evolving technological and policy realities.

In the fourteen years since the launch of the Doha Round in 2001, very little progress has been made on services.<sup>1</sup> Rising frustration at what many regarded as the relative neglect of the subject in the negotiations, as well as the insistence of some members for results in agriculture ahead of services, recently prompted a group, currently comprising 23 members representing 52 economies and 70% of global services trade, to pursue the negotiations on a plurilateral basis outside the WTO. This subgroup of like-minded WTO members embarked upon a negotiation aimed at establishing a Trade in Services Agreement (TiSA). The implications of this development are explored in section 2.3 below.

The services sections forming part of preferential trade agreements (PTAs) vary in approach and detail. They make up a criss-crossing mosaic that is sometimes complementary to the GATS, and sometimes less so. In certain instances they go further than GATS, or depart from the currently prevailing structure of GATS schedules, or contain provisions more reflective of services markets today and could show the way for an improved multilateral approach (Latrille and Lee 2012; Mattoo and Sauvé 2011; Roy 2011). In other cases they detract from GATS and have even been dubbed “GATS-minus” (Adlung and Miroudot 2012).

In more recent years, a push has taken place to develop mega-regional PTAs. These include the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership Agreement (RCEP), the Transatlantic Trade and Investment Partnership (TTIP), the Tripartite Free Trade Area (TFTA), the Continental Free Trade Area (CFTA) and the Pacific Alliance.<sup>2</sup> None of these ongoing negotiations have been completed to date and the likely contents of pending agreements have yet to be made publicly available.<sup>3</sup> But between them the mega-regionals account for the bulk of the global economy and the world’s population. They could have a profound influence on global trade and investment governance.

The task facing governments and other stakeholders is to find ways of rendering regimes for the regulation of services as relevant and supportive as possible to the challenges facing the global economy. Such arrangements must also be equitable to gain acceptance, and contribute to sustainability, development and growth.

Against this backdrop, experts in the E15 Expert Group on Services engaged in critical analysis and forward thinking on issues relating to a deeper and more comprehensive regime for services in the global economy. The experts have explored new thought and put forward fresh ideas on opportunities for reform and reinvigoration of international services regimes, especially at the multilateral level. The Group has striven to arrive at a set of viable and pragmatic medium and long-term policy options for trade officials, trade policy-makers and other stakeholders to consider, including for the post-Bali Doha Round agenda.

<sup>1</sup> The waiver permitting the preferential treatment of the trade of least developed countries, agreed at the Bali Ministerial Meeting in December 2014, stands out as an element of progress in services.

<sup>2</sup> The TPP comprises 12 economies on both sides of the Pacific. RCEP includes 10 ASEAN states and an additional 6 major Asian economies. The TTIP is a bilateral between the EU (with its 28 member states) and the United States. The TFTA involves 26 African countries and the African Union has also launched the CFTA. The Pacific Alliance implicates Chile, Colombia, Mexico and Peru.

In order to advance its work, the Group commissioned a number of thematic papers covering areas it considered of particular relevance to its task. These papers provided useful insights upon which to build a policy options narrative on services. The papers did not, however, cover all aspects of what the Group considered in terms of the more comprehensive approach envisaged in this exercise.

The commissioned papers looked at the changing context in which services should be analysed, the digitization of global commerce, small and medium-sized enterprises (SMEs) in services, the use of soft law in international rules, regulatory cooperation, and the relationship and possible integration of rules on goods and services in the context of international trade rules.

The Expert Group's discussion has led to a series of recommendations listed in section 3 of this report. Some of these may seem rather technical in nature, when gauged against the need for a comprehensive response to the huge changes that are taking place in the global economy. Their unifying characteristic is that they are all recommendations for action that could change the framework for future trade policies and negotiations. These policies and negotiations, as TheCityUK (2015) has underlined, "have tangible commercial value, and so are vital for business. They are core instruments for giving freer rein to comparative and competitive advantage in global trade and the creation of new markets, opportunities and access."

National policy-makers can benefit from the paper's analysis on this topic of increasing relevance to all national economies and to the global economic system. As the European Commission has emphasised (European Commission 2013), trade "has become an important means of achieving much needed growth and creating jobs without drawing on public finances." But for trade to perform this function, trade policy needs to be effective, sustainable over the long term, enable business to prosper and contribute to growth and wealth-creation. It is this objective that underlies the Expert Group's recommendations.

<sup>3</sup> After five years of negotiations, the TPP negotiations were closed on 5th October 2015. Ratification is now required by all signatories and this will be a contested process. Official summaries indicate that it contains provisions on e-commerce and free data flows as well as on opening up services markets.

# 2. Background to International Cooperation in Services

## 2.1. The Evolution of Services in the Global Economy

Services have needed rethinking for a long time in our changing world. Classical economic thought assigned zero value to services because they could not be accumulated. One consequence of this is the absence of historical data on services. Later thinking considered services devoid of scope for productivity growth and feared that their increasing dominance as a source of income would spell relative economic decline. Matters have been made no better by the invisible or intangible character of services and the difficulties of identifying and measuring them.

Greater appreciation of the contribution of services to economic activity began to take hold in the 1970s. It was not until the 1980s that governments saw the need to craft a multilateral agreement on services akin to the regime that had regulated goods since the late 1940s. Burgeoning preferentialism in trade relations from the early 1980s onwards saw the establishment of a growing number of PTAs containing provisions on trade in services, although most preferential services agreements were concluded post-Uruguay Round.

Economic growth and globalization, spurred on by technological advances, brought services into a new prominence as sources of income, trade, jobs and development (Rentzhog and Anér 2014). Key technological developments in information and communications technology and in transport, along with evolving business models, have driven the internationalization of production. Trade and foreign investment have worked in tandem, spreading value networks producing both goods and services across multiple economies. This process has intensified dependency on services, growing its share of value in production. A related development, also enabled largely by technology, has been the application of services innovation to facilitate growing customization of production in ever more complex and differentiated markets. This too has intensified the services components of production.

Through reducing the costs and barriers to cross-border exchange, technological advances in ICT, in particular, have greatly increased the number of firms engaged in trade via Internet platforms. Many of these firms are small but can serve a large customer base in multiple economies. The involvement of multiple firms in cross-border exchange—unconstrained by scale as a barrier to entry, logistical challenges and administrative burdens—represents an important structural change in the global economy driven predominantly by services. Relative to manufacturing operations, the minimum efficient scale of operations

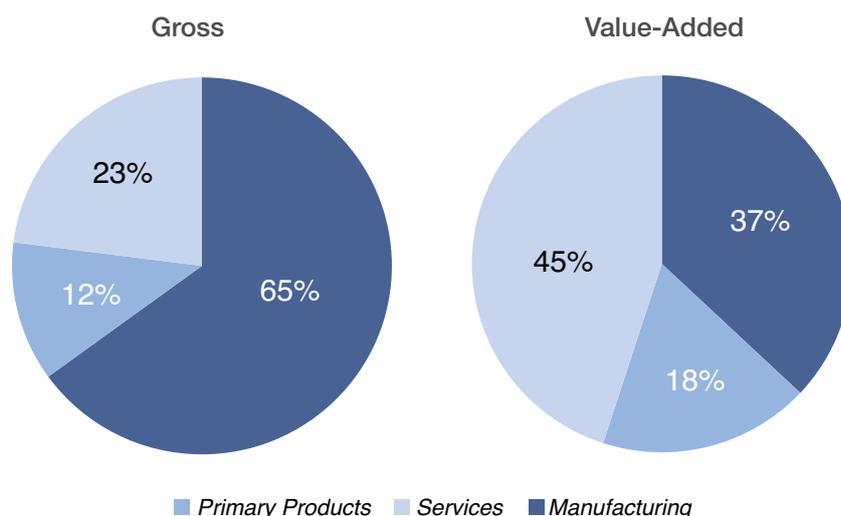
for service providing firms often tends to be smaller and less intensive in the use of physical capital. In some service sectors, this can offer significant catching up and technological leapfrogging opportunities for service suppliers from developing countries.

The consumption side of the story of growing services dominance in the global economy is also important. As people become richer, they spend proportionately more of their incomes on services. In this sense, economic development will always bias growth towards services, augmented in today's economy by the digital revolution and other technological advances. Moreover, the old neoclassical precept that the consumer is king has become truer than it ever was. The digital world of the Internet and social media has armed consumers with levels of information they never had before and rendered them more discerning and demanding. This has fed technology-enabled product differentiation across a swathe of consumer goods, and further stimulated services components in production.

The recently improved procedure of measuring trade in terms of value-added has also raised a hitherto dormant awareness of the importance of services in trade flows. Thanks to the work of various international agencies, governments and academic institutions, the use of international input-output matrices to capture value-added in traded products has led to a re-estimation of the services component of trade. Essentially, what the value-added measure of trade does is to net out the import component of exports in each economy, allowing a proper attribution of value to the location where it was generated. This addition in accuracy changes our understanding of the true nature of trade relationships in important ways. Bilateral trade balances no longer look the same when imports are netted out from exports. The technology content of bilateral trade flows can be very different in cases where, for example, complex products are assembled in an economy that reports the exports gross instead of netting out the hi-tech imports that go into exports. The true nature of the interdependent trade relationship between country pairs is thus more fully revealed.

When trade was only measured in gross terms without any consideration of the input breakdown and sourcing of traded products, the services component of cross-border trade was regularly reported as somewhat less than 25% of total value. The figure now is some 45% (Figure 1). This remains an underestimate on account of difficulties in measuring some services flows via the balance-of-payments accounts, and to the extent that services inputs into manufactures that are supplied in-house without any

**Figure 1: Sectoral Contributions to Trade, Gross and Value-Added Measures (2008)**



recorded arm's-length transactions will still be counted in the trade statistics as manufactures. One could make the same argument in respect of manufactures embedded in output identified as services exports, but this occurs far less frequently in practice. It should also be noted that the data used in these calculations pertain to 2008 and does not capture the degree of servicification that has occurred since.

The extension of a value-added measure from the traditional GDP calculation to trade flows has also reinforced awareness of the networked nature of economies—how putatively different markets are linked and what the true content is of traded products. A revelation emerging from the value-added approach is that all services entering the production of goods or services for export are in principle tradable. Services that are non-tradable if supplied in isolation can be “bundled” with goods (or other services) and traded as a composite offering. Take factory cleaning services as a simple example, where a factory produces footwear for export. Those cleaning services represent part of the value incorporated in the exported shoe and are therefore traded. As a stand-alone service, factory cleaning obviously cannot be traded, but this changes when that service is bundled with other sources of value generated in the production process. If all producer services can potentially be traded, this may raise questions about the sources of national comparative advantage and the scope for specialization. It is also a reminder that policies affecting one activity have ramifications for lots of other activities comprising joined-up production structures.

In terms of the GATS definition of services transactions, a more accurate accounting of the content of products in the context explained above would lead to the identification of more Mode 1 transactions.<sup>4</sup> Within the GATS definitional framework, access to foreign markets can, of course, also be secured through factor flows (Modes 3 and 4).

As noted briefly in introduction, the role of services in production, consumption and trade has evolved dramatically in the last few decades. Information-related and transport technologies have splintered production locationally and facilitated the separation of production and consumption over greater distances. At the same time, they have greatly shrunk space and time, providing a platform for the explosive growth of international trade and investment.

Innovation in services is also a significant factor in explaining the growing prominence of the sector (Miles 2006). Spontaneous networks of producers, consumers and entrepreneurs have combined technology and knowledge to generate innovative processes and products. Innovation and productivity gains in services are harder to pin down and measure than R&D-generated innovation in the goods sector. This is because innovation is more incremental and integrated in the production process as opposed to being undertaken by a designated R&D department.

A greater level of political willingness of governments to open markets to international trade and investment—as compared to the first half of the twentieth century—completed the mosaic upon which the world has globalized over the last six decades. In short, internationalized production and consumption, combined with changes in patterns of consumer behaviour have been the proximate causes of growing services-intensity in the global economy.

<sup>4</sup> The definition of services trade under the GATS is four-pronged, depending on the territorial presence of the supplier and the consumer at the time of the transaction. The GATS covers services supplied (a) from the territory of one Member into the territory of any other Member (Mode 1 - Cross-border trade); (b) in the territory of one Member to the service consumer of any other Member (Mode 2 – Consumption abroad); (c) by a service supplier of one Member, through commercial presence, in the territory of any other Member (Mode 3 - Commercial presence); and (d) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (Mode 4 - Presence of natural persons). From: WTO Trade in Services Division. 2013. The General Agreement on Trade in Services: An Introduction.

## 2.2. Servicification

The growing reliance on services as a source of economic activity led to the coining of the term “servicification” by economists at the Swedish National Board of Trade, and the term has assumed common usage in the literature (Rentzhog and Anér 2014). A parallel branch of literature referred to as “service science” (Low 2013) focuses on the same phenomenon, as does work by the OECD on “knowledge-based capital (OECD 2011, 2012). The definition given by Rentzhog and Anér (2014) of servicification — “a process whereby non-services sectors (both agricultural and non-agricultural) in the economy buy and produce more services, and also sell and export more services, often as a package deal with the good” — describes a core driver of the increasing share of services-generated value in the economy.

However, the demand for services must not be seen only as derived from other activities in the non-services and services sectors. Services themselves are directly consumed (e.g. travel, tourism, personal insurance and other financial services, business services, retail distribution, and so on) and a combination of growing customization and rising global incomes has vastly increased demand for services in these sectors as well.

The distinction here is between producer services and consumer services. The difference between the two can depend both on the nature of the service as well on the place in the value chain of the source of demand for a service. Leisure services, for example, would in most cases be consumption services. They do not enter production. Insurance services, on the other hand, can be producer services if they are inputs into a production process. Alternatively, insurance for household goods, for example, forms part of a consumption package and has nothing to do with production.

In the case of production inputs, services are multifunctional. They may simply be the glue that holds value chains together, conveying products or people over distances. These services may include transport, logistics and various ICT products. Secondly, they may be ancillary services that allow production to occur. Repair and maintenance services, management services, and various back-office services are examples. Finally, some services may be directly consumed in production, such as production monitoring or cleaning and refuse disposal. These distinctions may be heuristically helpful, but a proper enumeration of services along a value chain does not rely on them. Services entering production represent value regardless of their function.

Notwithstanding the distinction between production and consumption services as sources of value, a good part of the growing demand for services through a servicification process is associated with production dedicated to goods for final consumption and in that sense is derived. This applies regardless whether the final output of a value chain is a good or a service. Rentzhog and Anér (2014) report on a study by Sweden’s National Board of Trade (Kommerskollegium 2010) of a company called Sandvik Tools that consumes over 40 different services to sell and ship their products (Figure 2). That number would be even greater if all the services entering into the manufacture and post-sales maintenance of the tools were also counted in the value chain.

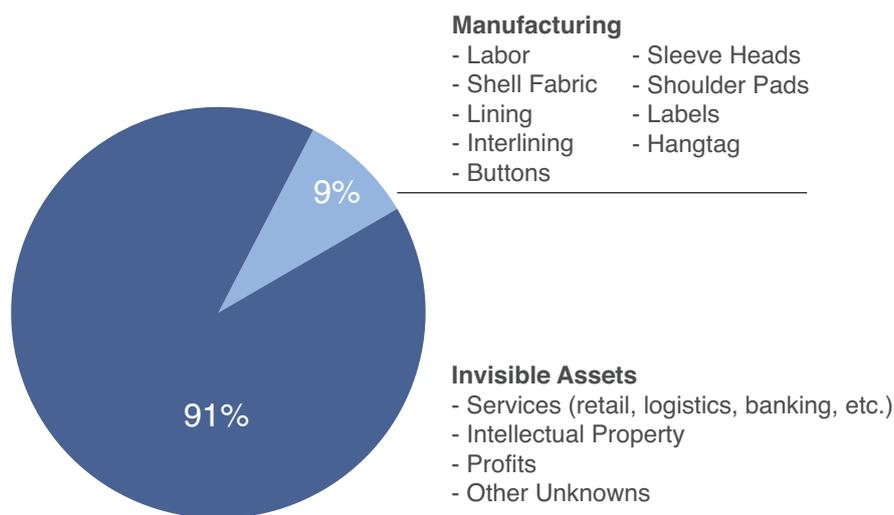
A range of other studies indicate similar outcomes. Low (2013) reports on the services component of the manufacture of a jacket (Figure 3). The share of the jacket attributable to physical inputs is only 9%. All the rest is comprised of invisible assets, including services and profits.

**Figure 2: Services Needed by Sandvik Tooling to Sell and Ship a Product**



Source: Swedish National Board of Trade 2010

**Figure 3: Manufacturing Cost and Invisible Assets of a Jacket**



Source: Low (2013)

The evolution of services and servicification in the global economy has resulted in a new world where services are recognized as a prominent source of economic activity and value creation—in production, trade, consumption, investment, employment, growth and innovation—and will continue to expand those contributions over time. The world of policy is trying to catch up. Improvements in data availability have demystified services to a degree, but there is a long way to go. Questions arise about the adequacy of arrangements for international cooperation in this domain. In particular, there is the question whether the GATS and preferential services agreements are fit for purpose in a rapidly changing world. These are the issues to be taken up in the rest of the paper.

### 2.3. International Cooperation in Services

Much has been written about international cooperation in services. Analyses have tended to focus on the GATS, but there is also considerable literature on what PTAs have been doing in services.<sup>5</sup>

The GATS was influenced in no small measure by the GATT and adopted parts of its legal structure. However, the GATS also incorporated some important additional features to address perceived differences between goods and services. Among the important differences were the inclusion in GATS of alternative means of trading services, involving cross-border movement of products, consumers, and factors of production. On the product market side, suppliers could send their services to consumers across frontiers just as in the case of goods, or consumers could cross frontiers themselves to consume foreign-supplied services. In factor markets, both investors and individuals crossing frontiers to supply services also came under the GATS umbrella.

Another important contrast with the GATT relates to the asymmetric treatment of rules on non-discrimination, particularly in regard to national treatment. While the most-favoured-nation (MFN) principle of non-discrimination among non-resident suppliers or suppliers applies (with exceptions) in GATS as in the GATT, the national treatment principle is negotiable in GATS while it is an *ex ante* across-the-board requirement in GATT. This difference reflects the multi-modal approach to trade transactions adopted in the GATS, the absence of tariffs as the prime instrument of border protection, and the relative insignificance of the border as a locus of regulation in services markets.

The GATS has also been criticized for a lack of clarity in regard to some provisions and definitions, which could have had a dampening effect on the willingness of governments to undertake obligations. Many GATS commitments were benchmarked at levels of access above those prevailing at the time the commitments were made. In the absence of further negotiations, over time the value of GATS commitments has been further diluted through autonomous liberalization or liberalization under regional initiatives. Gaps today between commitments and actual policies can be large (Miroudot and Pertel 2015). They detract from predictability in trade relations. The same phenomenon exists in the GATT.

As noted in the introduction, a subset of participants in the Doha Round have initiated negotiations on a separate Trade in Services Agreement. So far, TiSA is the only initiative outside the WTO to be launched with the specific purpose of substituting for a WTO negotiation. Assuming a successful completion of the negotiations, this could have serious implications not only for services negotiations in the WTO, but for the overall balance of the multilateral

<sup>5</sup> The issues touched on in what follows were discussed by the Expert Group. Useful insights emerged, with varying levels of convergence among members, but the group did not seek to negotiate and no explicit consensus was attempted among the views expressed. For this reason there is limited specific attribution to the Expert Group collectively. Where relevant, the paper has drawn heavily on the think pieces prepared for the group.

negotiating agenda. On the other hand, TiSA could also point the way to progress in negotiations under the GATS. Systemic concerns will largely evaporate if TiSA establishes a successful pathway towards multilateralization. The Council for Trade in Services is kept informed by TiSA participants on developments in the negotiations.

One view of TiSA is that its architects consider it open to all members, and the intention is to bring the agreement within the WTO and apply it on a non-discriminatory basis. This could be achieved by incorporating the results into the GATS schedules of the members concerned, taking on the form of a critical mass agreement like the post-Uruguay Round results on telecommunications and financial services. If this is the approach, a question that could arise is how any rule changes agreed in TiSA would be enshrined. Perhaps the Additional Commitments (Article XVIII) column in Members' schedules of commitments could serve the purpose. This presupposes, however, that the respective obligations add to and do not detract from currently existing GATS disciplines. Whether a critical mass approach is indeed the intention remains unclear, but it is noteworthy that China's request to join the TiSA in 2013 was not supported by all participants. An alternative is that TiSA will not be multilateralized, but be notified as an Economic Integration Agreement governed by Article V of GATS.

Whether or not TiSA succeeds, and whatever the form it takes, any future consideration of how to improve multilateral governance in services would benefit considerably from examining the provisions and experiences of PTAs that incorporate services provisions. The picture is mixed and complicated. Some evidence suggests that market access commitments have on average been far higher in services PTAs than in the GATS (Mattoo and Sauvé 2011; Roy 2011).

In contrast, Adlung and Miroudot (2012) found that most of the services-related 66 PTAs contained in an OECD database included GATS-minus provisions. These often take the form of "horizontal" (cross-sectoral) exclusions that go further than those contained in the respective GATS schedules, for example on such matters as national treatment for subsidies. These GATS-minus provisions are more frequently encountered with the so-called "NAFTA-type" PTAs as opposed to the "GATS-type" PTAs. A major difference between these two genres is that the former adopts a negative list approach starting from the assumption of full liberalization across all sectors and modes of supply unless restrictions are explicitly indicated. Under a GATS-type "hybrid" approach, each member only lists the sectors in which it undertakes access commitments in order then to specify departures from full liberalization under the mode(s) concerned. The implications of this difference will be taken up in the next section, but for present purposes it may be supposed that if everything not listed is covered by the provisions of the PTA, a precautionary measure would be to reserve the right to grant discriminatory subsidies across-the-board. Again, this creates a lot of uncertainty concerning the actual conditions of access to and participation in the respective markets.

Latrille and Lee (2012) undertake a comprehensive survey of some 84 PTAs containing services provisions to consider how divergent the PTAs were among themselves and from the GATS, and also how innovative or experimental the PTAs were. The authors employ the NAFTA-type and GATS-type distinction and find similar numbers of agreements adopting each approach, complemented by a smaller group of agreements containing NAFTA-type as well as GATS-type elements. They find that the NAFTA-type agreements treat investment provisions for both goods and services in a single set of provisions. They also observe some evidence of agreements going further than GATS, for example, by extending domestic regulation disciplines across the board, regardless of whether a sector is subject to market access commitments. In contrast, Article VI:4 calls for further work to establish or develop regulatory disciplines for services—including in respect of objectivity, transparency, and a least-trade-restrictive standard. Pending the completion of this work, the Agreement states that in sectors where specific commitments have been undertaken, these standards must be observed. The implication seems to be that a best endeavours approach to regulation is adopted in the interim for services not incorporated in a schedule of commitments.

Latrille and Lee (2012) also found evidence of a more open approach to mutual recognition of qualifications in some PTAs, which is not altogether surprising considering the likelihood that this occurs where the preferential partners are similar or more geographically proximate economies (Sauvé and Shingal 2014). On the other hand, Latrille and Lee identified various GATS-minus "framework" provisions in certain PTAs, including a redefinition of the governmental service carve-out and the omission of the nullification and impairment test relating to the provisional application of regulatory standards (GATS Article VI:5) in respect of services subject to specific commitments.

A final observation, previously noted briefly, is that since the time when the GATS came into force 20 years ago, the world of services has changed dramatically, for all the reasons previously discussed, such as developments involving the Internet and multiple services platforms for international transactions. At the same time, the GATS-mandated negotiations to progressively liberalize services markets and fill certain gaps in the rule-making agenda are making very little, if any, progress, leaving a number of issues unaddressed.

# 3. Policy Options: Rethinking Services Trade

This section focuses on the issues raised in the Expert Group's discussions and the think pieces the group commissioned to highlight matters of particular concern and possible recommendations for future action by governments. The discussion below draws heavily on these think pieces, which cover the digitization of global commerce (Bieron and Ahmed 2014), small and medium enterprises (SMEs) in services (Nordas 2015), the use of soft law in international cooperation (Low 2015), regulatory cooperation (Mattoo 2015), and the relationship and possible integration of WTO rules on goods and services (Sauvé 2015; and Drake-Brockman 2015). The related policy options are put forward for consideration at the end of each subsection.<sup>6</sup>

## 3.1. Services and the Digitization of Commerce

The digital revolution has been deeply transformative, but the policy response from governments has often been confused and contradictory. The digital revolution has reduced transactions costs in a variety of ways, raised productivity and contributed strongly to growth. It is a key driver of innovation and has brought about new products and new ways of producing and consuming old ones. It has reshaped business models and injected an unprecedented level of inclusiveness into commerce. The smallest enterprises can today aspire to serve markets worldwide. At the same time, large multinational firms have also relied increasingly on the Internet to do business, coordinate physically disperse operations and exchange information. Digitized commerce in its multiple forms will remain a key source of growth for decades to come, but is threatened by services nationalism, with particular implications for smaller competitors that rely on open trading platforms and global scale.

Digitized commerce relies very heavily on services, but also requires the physical assets of logistics providers, such as express delivery companies, to complete transactions where the output is physical. Bieron and Ahmed (2014) aptly refer to a Global Empowerment Network, comprising a combination of the Internet, platform services and logistics providers. Firms engaged in these activities can be of varying sizes, as there are limited barriers to entry.

On the policy front, measures that might hinder the smooth operation of Internet-based business raise questions going well beyond a concern for market access through cross-border transactions. They may relate to government concerns about security and privacy, or to the erosion of the tax base. Moreover, the integrated nature of Internet-based business involving goods also requires that logistics providers have a physical presence to supply their services. This implicates a different range of policies relating to investment, labour markets, transport, customs administration, and other regulatory measures bearing on access and the costs of doing business within and across borders.

Because of the decentralized architecture of the Internet and the absence of unifying top-down controls, governments and citizens—sometimes in quite different ways—are concerned about security, surveillance and privacy. Recent revelations about official access to private information, justified by governments on security grounds, have created discord among governments and upset individuals who feel their privacy can all too easily be intruded upon.

This has created pressures for finding ways of regulating and at times curtailing access to digitized information. One response has been to insist upon the localization of data processing and data storage at the national level. Many actors in the sector believe that such requirements can be costly and negatively impact on growth without advancing the goal of protecting personal data. Yet an appropriate level of access to information is a legitimate public concern that needs addressing, so a solution must be found. The GATS may be an effective instrument, particularly through its MFN and national treatment provisions, as well as the Annex on Telecommunications, for addressing many of the policy issues surrounding the digitized economy. However, the social and public policy aspects of security and privacy concerns may be beyond the capacity of a law-based international agreement like GATS to address adequately, thus reinforcing the need for information sharing and for developing best practices that address privacy-related concerns without unduly restricting the economic potential of trade in services delivered digitally.

<sup>6</sup> The policy options have been divided into issues that might be addressed in the short, medium or long term. The recommendations are predicated on discussions among the Expert Group in three meetings held in 2014-15 and should be read in conjunction with the thematic think pieces where these are available.

If technology and policy work together, viable solutions can be found to achieving balance between public policy concerns and the manifold benefits flowing from the digitized economy. A “hands-off” message to governments is not the answer. Instead, governments must understand the capabilities of the technologies used by business and leverage them to address their needs and cooperate more closely on such matters as information exchange, best practices to address social and political concerns, and improving encryption. In the longer-term, governments might negotiate a more comprehensive multilateral agreement on data flows and related privacy concerns.

In summary, the signal and growing importance of digitized commerce creates a strong interest among governments and other stakeholders in ensuring that data flows are as unencumbered and free as possible, subject to legitimate public policy concerns regarding privacy, law enforcement, taxation and national security. These latter concerns should be accommodated through international cooperation and understandings among the relevant authorities, and with a view to inflicting minimum costs on users of digitized means of communication and exchange.

**Policy Option 1: Short to medium term:** Using existing disciplines, institutional trade forums and ongoing bilateral and multilateral negotiations, governments should establish guidelines for regulating cross-border data flows, bearing in mind public policy concerns relating to law enforcement, privacy and national security. In this context, governments should:

- Clarify existing GATS provisions, including MFN, national treatment and the Annex on Telecommunications in terms of their application to cross-border data flows;
- Call upon WTO members to step up their efforts in deliberating those issues in the context of the WTO Work Programme on E-Commerce;
- Explore means of enhancing information exchange among governments, international organizations, services suppliers, consumers and other global stakeholders;
- Consider the possibility of adopting best practices relating to privacy, developed by agencies such as the OECD or Asia-Pacific Economic Cooperation (APEC), as part of an effort to draw a regulatory line between privacy and state access;
- Promote a maximum degree of interoperability internationally of privacy regimes;
- Agree on establishing adequate controls over the bulk collection of personal data;
- Focus on improving encryption and developing best practices to enhance the security of cross-border digital transactions;
- Engage in a process to assess the implications of requirements for data localization and cross-border restrictions on data flows in terms of their efficiency costs and effectiveness in attaining their stated objectives, including economic development, privacy protection and national security.

**Policy Option 2: Long term:** Consider the development of regulatory disciplines, the elements of which could be used multilaterally or in regional trade agreements (RTAs), on international trade in services delivered digitally and data flows that would confirm existing disciplines or establish new ones and encourage digital trade.

### 3.2. Services and SMEs

According to Nordas (2015), systematic data on small firms supplying and trading services are scarce. Standard information available from firm-level studies suggests that exporting firms—whether they sell goods or services—tend to be large and more productive than firms that do not export. They are also more likely to pay higher wages and be foreign-owned. Smaller firms are less likely to trade through investing abroad, but rather rely more on cross-border transactions.

This profile, however, obscures a good deal about SMEs supplying services and the extent of their engagement in trade. This is because the firms are too small to have much of an impact on averages. As also pointed out by Bieron and Ahmed (2014), a large and growing number of small and innovative services firms, whose core asset is human capital, maintain an active trading presence on the Internet. These firms have at their disposal a range of business models. They may sell and deliver online, or sell online and deliver offline. They may combine online and offline activities that require both cross-border sales and a commercial presence in the destination market. Many SMEs are likely to engage indirectly in trade, for example by securing a franchise with a foreign company to sell locally or supply after sales services. Or they may trade indirectly by providing services as inputs to lead firms who export directly.

Against the background of a flourishing digitized economy that has opened up new opportunities for SME services firms to enter global markets, Nordas poses the question of whether action is needed on the policy front to address obstacles to these activities. Before looking at specific policies, she observes that while SMEs account for a dominant share of employment in most economies, the popular image of SMEs as key creators of jobs is not borne out by the empirical evidence. Rather, it is new firms that create jobs and tend to innovate, and most new firms start small before growing into something larger, or failing. Some successful firms stay small as a matter of choice.

Entering export markets is costly and the larger a firm’s revenue from exporting, the easier these costs are to absorb. This restrains entry of SMEs into exporting unless they are particularly productive. In the absence of a situation in which export activity carries benefits for the economy at large, additional to those accruing from domestic market operations, support targeted at export activities by SMEs will not yield positive social benefits.

Instead, Nordas (2015) argues, governments should focus on removing obstacles to market entry, which can weigh disproportionately on small firms. Policies should not, however, be targeted on eligibility criteria that define SMEs, as this may encourage firms to stay small. Removing

obstacles to firm entry benefits all firms, regardless of whether they become exporters. An exception to this would be when a government assumes a role in facilitating information about foreign market conditions. This can be seen as an intervention that will benefit all exporters. Other broad-based policies should focus on reducing transactions costs, increasing flexibility in terms of the legal form that foreign establishments can take (foreign branches or representative offices rather than subsidiaries), eliminating unnecessary administrative burdens, facilitating entry by refraining from protecting incumbents, allowing freer data flows, protecting intellectual property rights adequately, and facilitating market exit when needed (bankruptcy).

Succinctly, advances in information and communications technologies in recent years have opened up numerous opportunities for SMEs to engage in international commerce. Yet because these enterprises are small, they are disproportionately affected by trade costs associated with processes, procedures, regulations and other technical burdens associated with cross-border trade.

**Policy Option 3: Short term:** Bearing in mind the new opportunities offered SMEs by the digitization of trade, consider the following actions to ensure that these opportunities can be realized:

- Call upon countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing and other administrative requirements;
- Recruit another international organization or an independent agency to rate and annually report on the progress of each country in this effort;
- Call upon countries implementing the Trade Facilitation Agreement to adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows;
- Encourage the establishment of online single windows for cross-border services providers in need of licenses, permits and other administrative requirements and explore the provision of Aid for Trade to implement this project in developing countries;
- Encourage the establishment of higher standardized *de minimis* customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers, especially SMEs;
- Explore the integration of national postal services into an interoperable, global, package-shipping network.

### 3.3. The Role of Soft Law

The notion of “soft law” seeks to capture gradations in the level of commitment to cooperation among parties. The lightest form of joint action might take the form of dialogue unaccompanied by any commitment beyond talking. From there cooperation could graduate to firmer undertakings, starting with information exchange, then moving on to consultation, comity and other forms of cooperation or understanding, and culminating in justiciable

legal undertakings. The distinction between soft and hard law turns on whether undertakings are enforceable through legal action. Interest in soft law arises from the idea that soft law can be a pathway to deeper understanding that ultimately can lead to the establishment of robust hard law. A second reason for thinking about soft law is that in some areas of cooperation, a more flexible and less binding form of cooperation may produce better results than contested hard law. Finally, the issues at hand, or prevailing realities, may be such that soft law represents the maximum level of attainable cooperation.

One definition of soft law in contrast to hard law is “normative provisions contained in non-binding texts” (Shelton 2000). The essential contrast here is between justiciability and non-justiciability. The precise meaning behind this definition depends on what is understood by the words “normative” and “provisions.” In considering the role for soft law in international agreements, Low (2015) has opted for a wide interpretation of these words. A normative provision is assumed to exist in all situations where governments have agreed to a non-binding form of words in a formal or legal text, or to a process or procedure, that may be interpreted as reflective of a shared aspiration rather than a legally enforceable one.

The justification for embracing such wide scope in meaning is two-fold. First, a catch-all definition accommodates multiple forms of exchange—modalities which can be identified in existing provisions and practices in the WTO and other international institutional arrangements today. Second, in practical terms an attempt to distinguish among degrees of softness in different non-justiciable provisions and processes does not seem a practical proposition in the absence of clear and broadly accepted metrics for doing so.

The “dos and don’ts” of non-justiciable exchanges may be implicit. They may entail different forms of learning interaction that lead to modified behaviour, voluntary compliance or evolving shared (and possibly binding and enforceable) commitments of a more explicit nature. Or they may be forms of words involving something that is still aspirational, or a best endeavours undertaking, but nevertheless specific. Sometimes these block-building elements of cooperation never become justiciable—perhaps because it would simply be impractical for that to be the case—and in other instances they may be pathways to hard law.

The experience of APEC in this context would be worthwhile examining. APEC has launched numerous initiatives over the years—not always implicating all 21 economies represented in APEC—to explore issues of mutual interest, exchange experiences, report on their own policies, and subscribe voluntarily to the monitoring of shared or self-declared targets. What eventually became the WTO Information Technology Agreement, for example, started out as an APEC initiative. Similarly, work on the definition of environmental goods and services in APEC has spurred further efforts to address these issues in the WTO. APEC initiatives are sometimes difficult to assess in terms of specific outcomes, but by embracing voluntary processes, relying on peer pressure, and avoiding a decision-making

formality that allows the exercise of a veto by one or more parties, the institution can deliver concrete results.

This is what might be termed the positive face of soft law. But soft law outcomes may also be less constructive and arguably undesirable if they lead to misaligned expectations or reflect incapacity to agree. In the interests of global governance, it might sometimes be better if undertakings, procedures or processes with unconstructive characteristics eventually take the form of hard law or if the soft law accommodation is eliminated altogether in the longer term. At the margin disagreements may arise as to an appropriate categorization among soft law manifestations.

Different instances of soft law can be found in the GATS, the WTO and other international agreements and texts. Provisions calling for notifications and consultations take the form of both hard law and soft law in WTO agreements, depending on whether they are designed more for the transparency end or the surveillance and monitoring (i.e. compliance) end of the spectrum. In all cases, rendering information more symmetrical and generally available is an essential ingredient of international cooperation, whatever form it takes.

Sometimes exhortatory or best endeavours language finds its way into hard law provisions, introducing a degree of non-justiciability in that context. Examples abound of such less-than-specific obligations. In GATS Article III, which deals with transparency, for example, Paragraph 4 provides that parties “shall respond promptly” to all requests by another party for information. The word “promptly” may be interpreted in different ways and the underlying notion could have been couched in terms of a time limit. In other cases, such as GATT Part IV, the Generalized System of Preferences and special and differential treatment provisions, the language is of a best endeavours nature. Provisions like these have arguably become a source of misaligned expectations and hampered cooperation in a broader sense.

On the other hand, best practice texts, guidelines and voluntary standards are likely to have tempered behaviour and perhaps in some cases allowed for the development of additions to hard law. The WTO’s Trade Policy Review Mechanism (TPRM) is an example of a soft law process that may be seen as a means of fostering better mutual understanding of national perceptions, constraints and aspirations. For some WTO members, reports generated by the TPRM process provide a clearer view of their own policy frameworks. It might be hoped that the Transparency Mechanism for Regional Trade Agreements will contribute in the same way as the TPRM, but its history is one of retreat from earlier efforts at setting hard rules on exceptions to non-discrimination principles for preferential trade deals. Many would argue things would have been better if movement had been in the opposite direction—that is, towards precise rules that could be used more readily to assess compliance with clear obligations.

Many observers, including some members of the Expert Group, have taken the view that one way of addressing the difficulties encountered by the WTO in recent years to advance agendas through negotiation is by deepening dialogue among governments. This has been variously referred to as a “missing middle” (Lamy 2007; Evenett 2009) and a “deliberative deficit.” The WTO Secretariat could be given a role to explore ways that governments may lessen the deliberative deficit through processes that may lead to better mutual understanding, the augmentation, clarification or removal of soft law, or its transformation into hard law. Any such exercise should draw on the experience of other international institutions and preferential trade agreements. Where best endeavours provisions are used, they would be less prone to misaligned perceptions and expectations if they were accompanied by accountability duties explaining how they had been used.

On the broader question of the role of soft law in the context of hard law frameworks, many participants in the Expert Group considered that trade in services, to a far greater extent than trade in goods, brings into prominence the question of how to articulate global rules with the sovereign right of governments to regulate. It is unlikely that all aspects of such jurisdictional sovereignty can be brought within the ambit of hard law based on binding international agreements. To that extent, it is probable that there will always be a need for some degree of soft law (in Shelton’s sense of “normative provisions contained in non-binding texts”) to cover those situations in which different countries wish to convey a shared objective of respecting each other’s positions but cannot commit to renouncing or pooling sovereignty through treaty obligations that would rigidly fetter their jurisdictional freedom. In turn, however, this raises the question of how to develop an enhanced approach to soft law, allowing it to function as means of catering for those issues without creating ambiguities or “papering over” real differences of view that need to remain clearly understood and respected.

Broadly defined, soft law can thus take many forms. It can foster dialogue on issues relevant to services and the trading system more generally without any presumption that it is a precursor to hard law. Such dialogue can increase mutual appreciation of multidimensional issues and contribute to more productive cooperation. It might take the form of best endeavours provisions that can encourage certain kinds of beneficial but essentially voluntary actions, or it can cover for disagreements and become a source of misaligned expectations. Best endeavours provisions may also establish a path towards hard law.

**Policy Option 4: Short term:** Within the limits of its mandate, encourage the WTO Secretariat to contribute in reducing the “deliberative deficit” by addressing current topics, suggesting areas for discussion, proposing ways of approaching issues, disseminating analysis and information, and developing dialogue with other international organizations dealing with relevant matters, including in the field of services. In this context, soft law developed outside the WTO should be studied to ascertain how it might inform domestic regulatory processes affecting trade in services.

**Policy Option 5: Medium term:** The WTO membership should explore ways of ensuring that best endeavours clauses play a positive role in international agreements:

- Where best endeavours provisions—or commitments calling for a lower level of discipline—reflect a process of moving towards hard law commitments, the nature of the economic or other conditions justifying a soft law approach should be spelled out, and in appropriate cases technical assistance should be a component in a transition away from soft law towards hard law;
- Best endeavours commitments should be accompanied by accountability duties, involving specific notification and monitoring provisions, especially if they risk creating misaligned expectations as to the effect of commitments contained in soft law texts.

### 3.4. Regulatory Cooperation

One reason why multilateral and regional services trade negotiations have not delivered a higher level of real liberalization is because they have followed the goods negotiating model of focusing almost exclusively on reciprocal market opening. Mattoo (2015) argues that this model did not work because countries are unwilling to risk opening many of their services markets unless the regulatory preconditions for successful liberalization have been fulfilled. These conditions include not just the existence of adequate national regulatory capacity but also a framework for international regulatory cooperation.

Consider why. Since services are intangible and many of them are consumed at the same time as they are produced, unlike goods they cannot be physically inspected at borders and their conformity with standards ensured before they are consumed. Regulators respond to the problem of national market failure in services by regulating their service providers. But efficiently regulating foreign services providers is a challenge because their operations can lie completely (in the case of cross-border trade or consumption abroad) or partially (in the case of commercial presence) outside the jurisdiction of a national regulator. As Mattoo (2015) puts it “for services to be globalized, regulation cannot remain national.”

Trade negotiators have not ignored domestic regulation, but seen it primarily through the lens of securing access to markets. Thus, the goal has been to ensure that the presence of prudential regulation or the absence of pro-competitive regulation in importing countries does not become a trade barrier. Where market failure due to informational problems—for example, in areas such as financial and professional services—prompts national regulators to impose licensing, qualification, and other requirements, rule-making has sought to ensure that these requirements do not unduly burden foreign providers. Where market failure due to monopolies—for example, in network-based services such as telecommunications and transport—allows incumbent firms to frustrate entry and competition, international rules have required national regulation to ensure fair access to essential facilities.

There are two problems with this market access-centred approach. The first is that existing international trade rules and commitments are hard to enforce and have uncertain value. It has always been difficult to strike a balance between allowing scope for the legitimate use of domestic regulation and preventing its protectionist abuse. Leaving the balance to be struck by the importing country's authorities risks allowing either less regulatory discretion than is politically acceptable domestically, or more regulatory discretion than is consistent with internationally predictable market access.

The second problem with this approach is that it does not facilitate new market opening and international commitments by helping national regulators deal with international market failure. A country will be reluctant to open its financial markets, for example, unless it is confident that it can prevent financial instability and loss for its consumers. The same applies to its data processing markets unless it can protect its citizens' privacy, or its transport and Internet-based services markets if it is afraid that the gains from liberalization will be appropriated by international oligopolies. Similarly, a country will demur at allowing entry to individual foreign service providers unless it is confident that they will not threaten its security. In some cases, such as the supply of services through locally incorporated subsidiaries, the importing country can in principle deal unilaterally with market failure because the provider is in its jurisdiction. But doing so requires adequate regulatory capacity and could lead to higher costs of trade by fragmenting markets (for example, by requiring local capital adequacy or the use of local servers). In other cases, such as cross-border banking, transport, or data-processing services, addressing market failure efficiently requires the cooperation of the regulator in the exporting country. This challenge is accentuated by the degree of heterogeneity that exists among jurisdictions in terms of institutions and social preferences.

Mattoo (2015) also identifies a “hold-back” problem. This can occur if stringent or discriminatory regulation inhibits specific market access and national treatment commitments. Adequate regulatory cooperation is crucial for continued market opening. Where this is absent, regulatory spillovers among jurisdictions can elicit trade restrictions. In the case of goods, the terms for entering a market can be separated from the regulatory assessment of whether acceptable product standards are met. With services, the greater need to focus on the supplier rather than the product will feed a reluctance to open the market.

Mattoo (2015) argues that greater regulatory cooperation can help address these problems. One dimension of such cooperation involves the assumption of obligations not just by importing countries but also by exporting countries when negative externalities are transmitted via exports of services. These exporter commitments need not be in the context of trade agreements, but could be secured in other existing or new forums for international regulatory cooperation. What matters is that market access commitments by importing countries would be transparently and predictably conditional on the fulfilment of specific conditions by exporting countries. Importing country regulators would then be

reassured that exporting countries will cooperate to protect their consumers' privacy, financial security, and well-being from the consequences of international market failures.

Another requirement is for regulatory assistance to support liberalization commitments by developing countries. Developing country policymakers would then know that any regulatory inadequacies that could undermine the benefits of liberalization will be diagnosed and remedied before any market-opening commitments take effect. This will yield better results rather than having market-opening negotiations take their course, as at present, with only ad-hoc links to international assistance for regulatory reform.

But even where regulatory cooperation prospers, a risk arises of exclusion. If cooperation occurs through harmonization and standards are too stringent, the costs for some countries, especially developing countries, may be prohibitive. If cooperation takes place through mutual recognition, exclusion arises through rules of origin. Here there is clearly a need to minimize the risk of exclusion. A part of this problem results from a tendency for members to notify mutual recognition agreements (MRAs) under the "closed" GATS Article V exception for regional agreements rather than under the "open" GATS Article VII on recognition. This may reflect an attempt to share these gains on a limited reciprocal basis by avoiding the obligation to extend recognition more widely. Aspects of the exclusion issue could be addressed through Aid for Trade activities or other technical assistance initiatives at both the multilateral and regional levels.

Discussions in the Expert Group also touched on aspects of the provisions in GATS Article VI on domestic regulation. Two issues in particular appeared to be of concern. One was the absence of a clear and comprehensive necessity test in GATS Article VI (the subject of a long-standing negotiating mandate under Article VI:5) in contrast to both the Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures. The necessity test under the two goods-related Agreements refers to the requirement to ensure that regulatory measures are only applied to the extent necessary to meet underlying public policy objectives, and should not constitute a disguised restriction on trade. Although some WTO members have expressed reservations about the inclusion of a necessity test in the field of services, and have failed to integrate even the currently applicable disciplines under Article VI:5 in their RTAs, such a provision would strengthen international regulatory discipline in both a multilateral and regional context.

The other issue relates to the extent to which agreements such as the GATS should rely on existing international standards. References to international standards in GATS (Article VI:5(b)) are minimal compared to the relevant TBT and SPS provisions. The GATS provision offers a weak incentive to apply such standards and only with respect to licensing and qualification requirements and technical standards. Other domestic regulations such as prudential measures and data protection may not be covered. This restrained use of the work of other standardizing bodies contrast with the TBT and SPS Agreements. Not only are

standards developed by other international bodies explicitly recognized, but there is a rebuttable presumption of compliance with the necessity test for measures conforming to international standards, guidelines or recommendations.

Moreover, the use of the word "standards" in GATS (in contrast to the TBT and SPS Agreements) does not accommodate the growing body of principles, guidelines and recommendations that have become internationally recognized benchmarks (for example, the Basel Committee's Core Principles for Effective Banking Supervision or the OECD's Guidelines on the Protection of Privacy and Transborder Flows of Personal Data). A similar case could be made for some standards developed by non-governmental organizations (for example, World Wide Web Consortium (WC3) standards or the Internet Engineering Task Force).

Greater consideration, accommodation and reliance in relation to the work of other international bodies would provide an opportunity to tap into a flourishing alternative regulatory machinery that can deliver regulatory outputs more responsive to market needs and quicker to adapt to change. This would make for a faster and more effective response to regulatory challenges arising from the internationalization of services transactions.

To summarize, regulation and market access obligations both affect the conditions of competition in markets. Regulatory cooperation is essential not only for facilitating trade, but also for reassuring negotiators and regulators that the consequences of liberalization commitments will be predictable in terms of policy outcomes. In order to secure progress in liberalization, national regulatory institutions may need to be strengthened and mechanisms created for international regulatory cooperation. Since such cooperation will often take place between a subset of countries, it is also important to watch out for the excluded countries. More could also be done to strengthen international norms on regulation in the area of services.

**Policy Option 6: *Medium term:*** Undertake the following work programme under WTO auspices and other relevant international and regional organizations.

- Identify the services sectors where weak national regulation can undermine the benefits of liberalization and establish mechanisms for diagnosing and remedying regulatory inadequacies in these services sectors, especially in developing countries. Develop country- and sector-specific recommendations on the appropriate sequence of regulatory reform and liberalization, as well as credibly commit assistance for the former where necessary.
- Identify the services sectors where the absence of adequate international regulatory cooperation can undermine the benefits of liberalization. Ensure greater coherence between international regulatory forums and trade negotiations, and that technical support and training is available to permit the participation of developing and least-developed countries in regulatory cooperation activities. Develop country- and sector-

specific recommendations on the appropriate sequence of international regulatory cooperation and liberalization.

These initiatives should build on existing arrangements in areas like financial, telecommunications and transport services, in order to establish a framework for mechanisms that ensure meaningful international cooperation in services sectors.

**Policy Option 7: *Medium term:*** Address the risk of exclusion created by regulatory cooperation among small groups of countries through a reaffirmation of relevant WTO provisions, a relaxation of exclusionary rules of origin and appropriate technical support to close gaps in standards between developing and developed countries.

**Policy Option 8: *Medium term:*** Institute processes in the WTO and elsewhere to consider ways of strengthening regulatory provisions in services, along the lines already established in the TBT and SPS Agreements and some preferential agreements, including through greater reliance upon the work of other international standardizing bodies.

### 3.5. Towards Greater Compatibility between Rules Governing Goods and Services

The rise of global value chains (GVCs) has increased co-dependency between goods and services and raised concerns about parallel structures of rules for global trade and investment governance. Virtually all arm's-length transactions in modern economies consist of bundled offerings, frequently of both goods and services. In this environment disconnected or stand-alone rules covering goods and services separately can raise costs, frustrate commerce and distort market outcomes.

This line of reasoning has led to suggestions for fusing the GATT and the GATS. Sauvé (2015) has raised four key questions in this regard. The first is whether the current contrasted and separate architecture for goods and services is compatible for a world in which GVCs are a significant feature of the economic landscape. Second, do existing rules offer a “coherent and predictable environment” for business? Third, how feasible would it be to fuse the two sets of rules? Finally, what other approaches might improve alignment between the two regimes?

The only one of the four questions to which Sauvé (2015) gives an unequivocally negative answer is the third. He believes the systematic fusion of rules for goods and services into a unified structure is neither possible nor desirable, although he does see possibilities for greater coherence in the manner in which goods and services are treated in certain areas of negotiation. He notes that not only are the rules in the two domains quite different but within both rule sets there is also considerable variety designed to accommodate diversity.

Sauvé (2015) argues that a number of fundamental differences between goods and services make diverse rule sets inevitable. First, he refers to intangibility. Other characteristics that distinguish goods and services are non-storability, the multiple ways in which services are delivered,

contrasting political economies of non-discrimination, reliance on quantity-based regulation in services, the degree of regulatory intensity affecting services, and the demonstrated lack, including in PTAs, of a negotiating appetite for rules on subsidies, safeguards and trade remedies in services.

Not all the contrasts are stark. On storability, modern technology has made a range of services storable when bundled with goods. Moreover, some perishable goods, like particular kinds of cuisine, have to be consumed as soon as they are made, and in very close proximity.

As for multiple delivery modes, the picture is again mixed. In a world of bundling, there are no longer any services entering production that are by definition non-tradable if they are bundled with other products—usually goods—that are exported. Similarly, if we define a Mode 3 for goods-related investment to parallel Mode 3 for services investments, we also have greater modal compatibility. The same could be said of a Mode 4 for workers in manufacturing and primary industries.

Mode 2 has always confounded some commentators because it is an undertaking by an importing party guaranteeing its own consumers the option of consuming in the territory of another party—that is, the exporter of the service. All the other modes are about access for supplies or suppliers. Nevertheless, one might envisage a similar Mode 2 purely for the consumption of goods.

The emphasis on quantitative restrictions as opposed to price-based interventions is more intense in services, and is in any case largely outlawed in the goods domain—save in exceptional circumstances. Why are services so regulation-intensive? Part of the reason, noted above, is technical, having to do with the intangibility of services and the tendency for them to be highly customized. This is an important difference with goods—service suppliers have to be regulated, whereas with goods the product itself can be the focus. Goods producers nevertheless have to be regulated, for example, in terms of environment, health and safety conditions in factories. The problem with regulation, of course, is that it lends itself to various forms of inefficiency and capture more readily than price-based instruments, and is likely to carry additional deadweight costs as a result.

Fusion of regulations on goods and services is not rendered impossible merely because regulatory targets are diverse and of different relative intensity. If greater uniformity were to be advantageous, it would need to be in terms of regulatory principles, standards set, and the procedural aspects of regulatory regimes. Without more work in this area, it is unclear what in practical terms such fusion would actually look like.

Drake-Brockman (2015) has attempted to assess the potential benefits of addressing the kinds of economic distortions likely to arise at the firm level from differences, disconnects and gaps in the rules affecting trade in goods and services in a world of increasing servicification. She sees potential opportunities for a more horizontal approach to addressing generic gaps in the rules on both goods and

services, for example with respect to issues such as cross-border data flows and e-commerce, which have arisen in the context of trade in services but which evidently also affect all other sectors.

The thrust of the above arguments is that closer integration of goods and services regimes may not be as technically infeasible, nor the differences between goods and services as stark, as is sometimes argued. Further work would be needed to tease out the details of what fusion would amount to in practice and what advantages would flow from it.

Current differences in the rules governing trade in goods and trade in services can also change incentives for firms to produce either “goods” or “services.” They may be induced to make future ownership, structural or locational decisions in what for them would otherwise be a non-optimal, cost inefficient manner. The possibility of safeguards, anti-dumping actions and countervailing duties under GATT but not GATS might, for example, incentivize a manufacturer to outsource assembly operations on a contract basis to entities that are legally independent of the producer (and owner) of the respective components (Adlung and Zhang 2012).

Drake-Brockman (2015) argues that, at their root, such situations raise economic questions, and the paucity of empirical research leaves them largely theoretical at present. When the international economics of servicification becomes more fully understood, Drake-Brockman suggests that new trade rules, as well as new soft law tools, will inevitably be needed in order to level the playing field between goods and services firms presently affected by dissimilar regulatory regimes. From this perspective, delay in international consideration of the prospects for “fusion” risks leaving the door open to new protectionist action, taking advantage of gaps, disconnects and differences.

Equally important, however, is whether the conditions exist for attempting significant architectural experiments. Sauv  (2015) recalls that the willingness and ability of governments to sit down and work on such an endeavour is certainly in doubt. Furthermore, this would need to take place against a domestic policy backdrop that aims at greater coherence across goods, services and investment. This leads to the conclusion that given uncertainty as to what the economic advantages would amount to, the need for further policy research, and the deep challenge of marshalling political support for such an effort, the pursuit of a “radical” fusion agenda may not be worthwhile in the foreseeable future. What could be worthwhile, however, is an exploratory exercise among governments, as well as other stakeholders, of arguments for augmenting compatibility between the two policy sets and practical ways this could be brought about.

A cluster approach to addressing fractured rules has also been mooted. This would mean dividing activities along sectoral or activity-specific lines and establishing an integrated rule-set around the cluster. The biggest problem with this approach is that in a world where everything is networked, defining the cluster boundaries would have an element of arbitrariness about it. This could fracture the policy regime in a broader sense and introduce distorting and costly discontinuities.

As Sauv  (2015) argues, however, the rejection of such an agenda does not mean there is nothing to be done about increasing compatibility between rules on goods and services in international agreements on certain cross cutting areas. A first area for serious consideration is investment. Global value chains rely crucially on foreign direct investment. Sales of multinational corporation foreign affiliates amount to more than US\$30 trillion a year (UNCTAD 2014). That is significantly in excess of global trade flows at around US\$24 trillion (WTO 2014). We have investment rules for services in GATS, albeit partial ones that cover market access and national treatment, but not investor protection in a comprehensive manner. The GATT does not contain rules on investment. Multilateralizing the thousands of bilateral investment treaties that have grown in number over the years and building a global investment regime would be politically challenging but would remove a significant distortion from the system.

In addition, Drake-Brockman (2015) and Sauv  (2015) argue that if investment rules could be brought together, the same logic should be made to apply to the movement of labour. Such an idea would probably be met with strong opposition, although some authors have suggested that one way to promote labour mobility for temporary stays would be for the labour-supplying economy and the labour-importing economy to work together to manage the flow. Other ways of doing this involve an examination of, and agreed procedures and time frames for processing work permits and visas for the temporary presence of natural persons. Ideas might also be gleaned from the experience of regional initiatives, such as the introduction of the APEC Business Travel Card. A volume edited by Mattoo and Carzaniga (2003) contains several contributions on what cooperation between supplying and receiving countries could mean in different jurisdictions.

Sauv  (2015) further highlights three areas where more comprehensive, consolidated, rules could pay dividends. These are, first, the inclusion of services in the Information Technology Agreement. Second is the possible inclusion of the logistics/transport/border administration cluster of services into the Trade Facilitation Agreement. In a sense, they are already there, for example, in the provisions on the use of customs agents. The third suggestion is to bring environmental services more explicitly into the current work on environmental goods. This is under active consideration in APEC and also has the support of the European Union within the ongoing WTO talks. The last two of these may encounter the problem of defining borders mentioned above in relation to activity or sectoral clusters, but all three of these ideas would certainly be worth exploring further.

As noted earlier, the present negotiating atmosphere militates against this kind of creativity, but this may not always be so. In all the cases suggested above for considering new approaches to bringing rules on goods and services closer together, careful attention would need to be paid to the details of making closer integration happen. But political pushback and technical challenges should not be allowed to head off further exploration in the future.

One way of addressing these issues—where there are likely to be significant gains from greater coherence but where both technical and political alignment among governments are essential—would be to establish a Working Group open to all WTO members, or some other mechanism if a WTO Working Group were considered premature, to examine the issues and make recommendations.

To recapitulate the ideas presented above, in a real world context where business decision-making involves joined up treatment of interdependent elements of trade and investment activities, questions arise as to the wisdom and utility of today's parallel legal and institutional treatment of rules on trade and investment in goods and services. To a greater or lesser degree, this issue arises in both multilateral and preferential rule-making settings, though most explicitly in the WTO setting. Should governments try to rationalize fractured rule sets in order to render them more relevant and less distorting? Certain pointers as to where such action would be both feasible and useful are suggested here. While arguments regarding the technical or legal difficulties or willingness and interest among governments of acting on such an agenda must be taken seriously, they should not constitute an embargo on deliberation.

**Policy Option 9:** *Short term:* Call upon governments, with the assistance of the WTO, World Bank, UNCTAD and OECD, to engage in analytical work, aiming at better understanding and raising awareness of the imperative of policy coherence across the areas of trade in services, trade in goods and investment.

**Policy Option 10:** *Medium term:* Constitute a Working Group open to all WTO members or some other mechanism to examine the desirability and feasibility of reducing distortionary parallelism in separate rule sets affecting goods and services in the domains of both trade and investment. This exercise should take account of possible lessons from alternative approaches adopted by preferential trade agreements. Such a Group might start its work by considering the following possibilities:

- Identifying areas of trade law where the playing field might not be level between goods and services firms;
- Bringing together international rules on investment in goods and services, as well as rules on the movement of people, taking into consideration the implications this would have in terms of extending multilateral disciplines to investment and people movement beyond those existing for services under GATS;
- Bearing in mind possible risks associated with splintering trade rules along sectoral lines, consider the possibility— as has already emerged in the procurement field—of including both goods and services in some stand-alone agreements such as the Information Technology Agreement, the Trade Facilitation Agreement, and an agreement dealing with environmental products as well as in possible future agreements in areas like cross-border data flows and e-commerce.

### 3.6. Other Suggestions for Modifications to the GATS

The rich discussion in the Expert Group cannot be fully captured here, but a number of ideas emerged that are helpful in scoping policy options. Interesting discussions took place on the origins of the GATS and how it has evolved. Various members of the Expert Group identified further areas where improvements to existing rules could usefully be contemplated. Some of these are covered in the above discussion of the thematic papers. A selection of additional issues is mentioned here for inclusion in the listing of policy options.

#### 3.6.1. Improving access for the temporary mobility of people

Mode 4 of the GATS dealing with the movement of people is the most sensitive and least yielding in terms of commitments of all the modes. This is unsurprising considering the nature of contemporary economic and socio-political realities in this area. Sensitivities also arise concerning the length of stay of non-resident service suppliers, the equivalence of professional qualifications and capabilities, and employment and learning opportunities for local service providers. One or other of these concerns is present in virtually all economies. Without ignoring the worries of governments, more could be done to clarify GATS provisions and those found in preferential agreements. More could also be done to render more transparent and streamlined procedures associated with working visas and permits for temporary presence. In addition, regulatory cooperation between source and host countries on such matters as pre-screening, acceptance and facilitation of returns, controls over illegal immigration, and where appropriate, the operation of agencies responsible for recruiting and managing transfers of cross-border service suppliers, can all be strengthened.

Improvements in these areas could considerably reduce the costs of doing business. The temporary presence of non-residents who enter foreign markets to supply services has grown in importance with the internationalization of production. Global value chains require a continuing stream of people across frontiers to enable flows of goods, services and knowledge. The growing importance of digitized commerce that requires elements of expertise from non-resident suppliers of services also argues for improvements in temporary presence regimes. The bundling of goods and services to create value has increased complementarities and strengthened the case for an integrated “Mode 4 approach” that also encompasses manufacturing activities. The need for a larger bargain on Mode 4 trade is also rooted in underlying global demographics and chronic skills shortages in a number of sectors.

Opportunities thus exist for reaping greater benefits from trade involving the temporary movement of natural persons across frontiers to provide services. Realizing these benefits does not require any modification to nationally determined public policy priorities with respect to such activities. Rather they rely on greater legal clarity and procedural efficiency, combined with closer regulatory cooperation among governments.

**Policy Option 11: Short term:** Launch a process to examine ways of accruing greater benefits from temporary cross-border movement of people supplying services. The experience of preferential agreements covering temporary movement of persons should also be taken into account. Specifically, consideration should be given to:

- Call upon WTO members to clarify GATS provisions in relation to how the Agreement covers processes and procedures related to visas and work permits;
- Improving transparency in relation to national conditions, procedures and processes for issuing visas and work permits;
- Strengthening regulatory cooperation between governments for managing the entry and stay of natural persons for the supply of services.

### 3.6.2. The use of negative lists for scheduling

It might be argued that in identifying a party's commitments under an agreement, listing commitments assumed (positive list) or exceptions taken (negative list) ultimately amounts to the same thing. Although this may be true in a technical sense, the dynamics of each approach differ and are likely to result in different outcomes in terms of the coverage of scheduled commitments. If exceptions from commitments are listed, by implication everything else is covered. That default has properties lacking in the positive list approach. In our rapidly changing world, where new services emerge with a certain frequency, commitments would apply to all new services, unless a party explicitly excludes new services from automatic inclusion arising as a result of the negative listing dynamic. This has occurred in some negative list agreements, which weakens arguments contrasting the two approaches. Where exceptions are not taken, the negative list will lock in the regulatory *status quo* rather than introducing a gap (“water”) between commitments and actual policy. Experience so far with GATS points to a lot of water in commitments, which significantly diminishes their commercial value to business users.

The political economy implications of drawing up comprehensive negative lists of non-conforming measures may deter members from taking exceptions that are not of paramount importance. This suggests that a higher level of binding commitments would be forthcoming. Still, the exercise of sifting through the entire services sector to identify exceptions can build awareness on policy opportunity costs and can represent a valuable exercise in transparency, inter-agency cooperation and dialogue, and the promotion of good governance.

Many consider the case for a negative list approach to be strong, suggesting that this is why it has been used in a number of preferential agreements and bilateral investment treaties (BITs). It should be noted, however, that BITs tend only to cover national treatment and not market access. This may make it easier to accept a negative list (and for that matter a “ratchet”—see below) than in a situation when both national treatment and market access are covered. The case for a negative list approach is less convincing for

others, both in terms of a propensity in some jurisdictions to carve out large exceptions whichever approach is used, and the challenges implied for regulators, especially in developing countries. There would doubtless be some technical issues to be addressed in switching from positive to negative listing under the GATS, and it would have to be an incremental process complemented as appropriate by technical assistance. Another potential concern with the negative listing approach is that capacity-constrained developing countries with limited resources may end up with unintended commitments—surely not a desirable outcome. Adlung and Mamdouh (2014) question the need to adjust the GATS itself in order to accommodate negative listing. They argue that the GATS is written in a manner that precludes nothing in terms of decisions by individual governments to choose their scheduling methodology. Whether this flexibility is deployed to strengthen the level of commitments is a matter of political preference rather than technical limitations embodied in scheduling methodology. The real question, however, is whether a joint decision to make a negative list approach mandatory would be desirable—assuming agreement were even possible—as a means of strengthening levels of commitments. Governments might consider what would be possible and desirable in this area.

### 3.6.3. Nomenclature

It has long been argued that the absence of a standard nomenclature in GATS schedules was a source of confusion. The Secretariat's W/120 nomenclature has served as a guideline for many in describing the services listed in their schedules of commitments. The product breakdown is highly aggregated and in any event nothing obliges WTO members to follow that nomenclature. The more disaggregated United Nations Central Product Classification (CPC), upon which the 160 categories identified in W/120 are based, was not acceptable to all WTO members as the basis for classifying services. This situation is different from that in goods trade, where the Harmonized System Description and Coding System (HS) is a common classification system for goods, which is comparable internationally for around 5,000 products at the 6-digit level.

A relevant question, especially in the age of servicification, is how far it makes sense to pursue a goods-like uniformity for scheduling in the domain of services. The Scheduling Guidelines developed in the GATS context recommend the establishment of a concordance with the CPC or otherwise to give a sufficiently detailed definition of a product to avoid any ambiguity in relation to the scope of a commitment. A question to consider, however, is how far uniformity in nomenclature is important in disputes when a panel has to determine the scope of a commitment. The question of uniformity in nomenclature would seem to be a matter worth further reflection on the part of governments, keeping in mind the difficulties of converting numerous existing commitments into a new nomenclature.

#### 3.6.4. Elimination of “water” in commitments and a “ratchet” clause

It has long been observed that the value of bound commitments, whether in the sphere of goods or services, is greatly diminished if bindings do not represent the prevailing level of openness. In GATS, the bulk of commitments, particularly those of some developing country participants in the Uruguay Round, fall short of actual practice (“*status quo*”)—the gap being the “water” in the schedules. Eliminating the water would make an important contribution to predictability and the level of market access disciplines assumed by parties to the agreement.

In addition, it has been suggested that maintaining *status quo* bindings—that is, bindings reflecting the actual level of permitted market access—in a dynamic sense could be assured through a ratchet clause. This clause would ensure that parties would be bound by any subsequent improvements in the terms of access at the time of their introduction. If a negative list approach to scheduling was adopted, the need for ratcheting would arise for items inscribed in reservation lists. In the case of measures not included in such lists, all obligations in the agreement would automatically apply. A ratcheting provision would, of course, also apply to positive list scheduling.

The embrace of a ratcheting provision may embody technical complications and monitoring challenges. More importantly, a ratcheting requirement could introduce a reluctance on the part of members to assume commitments. On the other hand, a similar provision (although not called a “ratchet” at the time) was stipulated in the Protocol of Provisional Application of the GATT (1947) and has proven useful over the years in locking in regulatory changes in the direction of greater conformity with treaty obligations.

As presented above and in the two preceding subsections, the Expert Group discussed a range of issues and options relating to GATS disciplines on scheduling and how to improve procedures and techniques in order to increase the consistency, depth, and clarity of scheduled commitments. As with many other aspects of the Group’s discussions, no firm shared conclusions were reached. Nevertheless, the issues warrant further reflection.

**Policy Option 12: *Medium term*:** Call upon WTO members to examine various aspects of scheduling practices in the GATS, as well as alternatives deployed under preferential agreements, with a view to considering possible ways of improving existing arrangements. Areas to assess the desirability of change include:

- Progressively switching to the adoption of negative listing in GATS schedules of specific commitments;
- Working on a more standardized system of nomenclature for the scheduling of specific commitments;
- Establishing a “roll-back and standstill” negotiating modality that could be applied horizontally to align items listed in schedules of specific commitments with *status quo* policy in order to eliminate “water” in commitments.

# 4. Next Steps and Conclusion

As a result of the contemporary evolution of services and servicification, as well as improved awareness and measurement of services as a source of value creation, the concept of trade in the early 21<sup>st</sup> century may need to be understood differently. This report, arising from a vibrant and forward-looking expert dialogue process, seeks to provide a comprehensive overview of a set of critical issues related to international cooperation in services where progress has either been achieved or is dormant, and offers guidance on a set of present and future priority areas for analysis, negotiation and policy intervention.

These priority areas include work on identifying frameworks in the WTO and elsewhere that could better integrate rules on trade in goods, trade in services and investment, examining positive approaches to services disciplines developed in different institutional settings, promoting an enhanced approach to soft law in the articulation of rules for services, creating mechanisms for improved international regulatory cooperation while addressing the risks of exclusion, and more structured policy responses to the profound transformations brought about by the digital revolution.

The policy options are presented over an indicative time horizon. The short-term options are mostly related to analytical and exploratory work that can be undertaken immediately whereas the medium and long-term options are of a more substantive nature and might require significant effort. It should be noted that members of the Expert Group did not always agree on the primacy of certain recommendations or on where the institutional locus of responsibility should lie in pushing the options forward.

Nevertheless, the main objective is to sow the seeds of ideas that will feed into the decision-making process so that trade policy can perform its function as an important means of achieving growth, employment and sustainable development. Policy-makers and other stakeholders from countries at all levels of economic development can benefit from the paper's analysis and policy proposals.

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## Overview Paper and Think Pieces E15 Expert Group on Services

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The papers commissioned for the E15 Expert Group on Services can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Services and the digitized economy</b>			
<b>1. Establish guidelines for regulating cross-border data flows.</b>	Short to Medium Term	<ul style="list-style-type: none"> <li>- WTO Reference Paper on Telecommunications concluded in 1996 before Internet and cross border data flows became prominent in international trade.</li> <li>- WTO Programme on E-Commerce has been unable to make recommendations on cross border data flows or to reach a definition on e-commerce.</li> <li>- Regional organizations and bodies have been able to go further and develop understandings on data privacy, but this has not been taken up at the multilateral level.</li> <li>- There is little interoperability of privacy regimes for data internationally, which acts as a deterrent to trade flows.</li> <li>- There is also no agreement on controls over the collection of personal data.</li> <li>- Varying methods for data encryption exist between countries, complicating cross border digital transactions.</li> <li>- Several countries have recently enacted regulations for the localization of data servers, which restricts cross-border data flows and impedes international trade in efficiency terms.</li> </ul>	<ul style="list-style-type: none"> <li>- Clarify existing GATS provisions, including MFN, national treatment, and the Annex on Telecommunications in terms of their application to cross-border data flows.</li> <li>- Call upon WTO members to step up their efforts in deliberating those issues in the context of the WTO Work Programme on E-Commerce.</li> <li>- Consider the possibility of adopting best practices relating to privacy, developed by agencies such as the OECD or Asia-Pacific Economic Cooperation (APEC), as part of an effort to draw a regulatory line between privacy and state access.</li> <li>- Promote a maximum degree of interoperability internationally of privacy regimes.</li> <li>- Agree on establishing adequate controls over the bulk collection of personal data.</li> <li>- Focus on improving encryption and developing best practices to enhance the security of cross-border digital transactions.</li> <li>- Engage in a process to assess the implications of requirements for data localization and cross-border restrictions on data flows in terms of their efficiency costs and effectiveness in attaining their stated objectives, including economic development, privacy protection and national security.</li> </ul>
<b>2. Consider the development of disciplines on trade in services delivered digitally and data flows.</b>	Long Term	<ul style="list-style-type: none"> <li>- The digital revolution has been deeply transformative but the policy response has often been confused and contradictory.</li> <li>- If technology and policy work together, viable solutions can be found to achieving a balance between public policy concerns and the benefits flowing from the digitized economy.</li> </ul>	<ul style="list-style-type: none"> <li>- Build on the above.</li> <li>- The elements of regulatory disciplines could be used multilaterally or in RTAs.</li> <li>- Confirm existing disciplines or establish new ones and encourage digital trade.</li> </ul>

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Services and SMEs</b>			
<b>3. Ensure that new opportunities offered SMEs by the digitization of trade can be realized.</b>	Short Term	<ul style="list-style-type: none"> <li>- There is no single point of enquiry for cross border services providers and the national enquiry points envisaged by the GATS are designed for use by government officials and not by services providers.</li> <li>- To date, only 17 countries have ratified the Trade Facilitation Agreement (TFA). The lack of digital enabling single window for customs and border compliance currently disadvantages SMEs services providers to trade via Mode 1. The more countries that commit to this technological step, the more opportunities it would offer for SMEs from developing countries to export services.</li> <li>- There are many different levels of <i>de minimis</i> customs levels for small packages in international trade. This varies country by country and discourages digitally enabled electronic commerce, especially from SMEs.</li> </ul>	<ul style="list-style-type: none"> <li>- Call upon countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing, and other administrative requirements.</li> <li>- Recruit another international organization or an independent agency to rate and annually report on the progress of each country in this effort.</li> <li>- Call upon countries implementing the TFA to adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows.</li> <li>- Encourage the establishment of online single windows for cross-border services providers in need of licenses, permits and other administrative requirements and explore the provision of Aid for Trade to implement this project in developing countries.</li> <li>- Encourage the establishment of higher standardized <i>de minimis</i> customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers.</li> <li>- Explore the integration of national postal services into an interoperable, global, package-shipping network.</li> </ul>
<b>The role of soft law</b>			
<b>4. Encourage the WTO Secretariat to contribute in reducing the “deliberative deficit.”</b>	Short Term	<ul style="list-style-type: none"> <li>- WTO members traditionally emphasized deliberation through negotiation, with limited exchanges outside of this. This has stymied the ability of the WTO to advance understanding and discussion on key trade issues, including those involving services and regulatory processes.</li> </ul>	<ul style="list-style-type: none"> <li>- Address current topics, suggest areas for discussion, propose ways of approaching issues, disseminate analysis and information, and develop dialogue with other international organizations dealing with relevant matters, including in the field of services.</li> <li>- Soft law developed outside the WTO should be studied to ascertain how it might inform domestic regulatory processes affecting trade in services.</li> </ul>

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status and Gaps</b>	<b>How to get there</b>
<b>5. Explore ways of ensuring that best endeavours clauses play a positive role in international agreements.</b>	Medium Term	<ul style="list-style-type: none"> <li>- The WTO currently has no mechanism for assessing the relationship between best endeavours provisions and hard law obligations.</li> </ul>	<ul style="list-style-type: none"> <li>- Where best endeavours provisions reflect a process of moving towards hard law commitments, the nature of the economic or other conditions justifying a soft law approach should be spelled out, and in appropriate cases technical assistance should be a component in a transition from soft law towards hard law.</li> <li>- Best endeavours commitments should be accompanied by accountability duties, involving specific notification and monitoring provisions, especially if they risk creating misaligned expectations as to the effect of commitments contained in soft law texts.</li> </ul>
<b>Regulatory cooperation</b>			
<b>6. Undertake a work programme to identify services sectors where the benefits of liberalization might be undermined by (i) weak national regulation, and (ii) inadequate international cooperation.</b>	Medium Term	<ul style="list-style-type: none"> <li>- These initiatives should build on existing arrangements in areas like financial, telecommunications, and transport services in order to establish a framework for mechanisms that ensure meaningful international cooperation in services sectors.</li> <li>- The work programme should be undertaken under the auspices of the WTO and other relevant international and regional organizations.</li> </ul>	<ul style="list-style-type: none"> <li>- Establish mechanisms for diagnosing and remedying domestic regulatory inadequacies in these sectors, especially in developing countries. Develop country- and sector-specific recommendations on the appropriate sequence of regulatory reform and liberalization, and credibly commit assistance for the former where necessary.</li> <li>- Ensure greater coherence between international regulatory forums and trade negotiations, and that technical support is available to permit the participation of developing countries in regulatory cooperation activities. Develop country- and sector-specific recommendations on the appropriate sequence of international regulatory cooperation and liberalization.</li> </ul>
<b>7. Address the risk of exclusion created by regulatory cooperation among small groups of countries.</b>	Medium Term	<ul style="list-style-type: none"> <li>- If regulatory cooperation occurs through harmonization and standards are too stringent, the costs for some countries, especially developing countries, may be prohibitive.</li> <li>- If cooperation takes place through mutual recognition, exclusion arises through rules of origin. Part of this problem results from a tendency for members to notify mutual recognition agreements under the “closed” GATS Article V exception for regional agreements rather than under the “open” GATS Article VII on recognition.</li> </ul>	<ul style="list-style-type: none"> <li>- Reaffirmation of relevant WTO provisions, relaxation of exclusionary rules of origin and appropriate technical support to close gaps in standards between developing and developed countries.</li> <li>- Aspects of the exclusion issue could be addressed through Aid for Trade activities or other technical assistance initiatives at both the multilateral and regional levels.</li> </ul>

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status and Gaps</b>	<b>How to get there</b>
<b>8. Institute processes to consider ways of strengthening regulatory provisions in services.</b>	Medium Term	<ul style="list-style-type: none"> <li>- There is an absence of a clear and comprehensive necessity test in GATS Article VI.</li> <li>- References to international standards in GATS are minimal.</li> <li>- The GATS provision offers a weak incentive to apply such standards and only with respect to limited areas.</li> </ul>	<ul style="list-style-type: none"> <li>- This could be done along the lines already established in the TBT and SPS Agreements and some preferential agreements, including through greater reliance upon the work of other international standardizing bodies.</li> </ul>
<b>Greater compatibility between rules governing goods and services</b>			
<b>9. Engage in analytical work on policy coherence across the areas of trade in services, trade in goods and investment.</b>	Short Term	<ul style="list-style-type: none"> <li>- WTO rules were created with separate bodies of rules for goods and services and a lack of multilateral disciplines on investment. This structure does not reflect how businesses invest, produce and trade in the 21<sup>st</sup> century.</li> </ul>	<ul style="list-style-type: none"> <li>- The WTO, World Bank, UNCTAD and OECD should provide assistance to governments in this analytical work aimed at the understanding and awareness of the imperative of policy coherence.</li> </ul>
<b>10. Constitute a working group (or other mechanism) to examine the desirability and feasibility of reducing distortionary parallelism in separate rule sets affecting goods and services in the domains of trade and investment.</b>	Medium Term	<ul style="list-style-type: none"> <li>- Closer integration of goods and services regimes may not be as technically infeasible, nor the differences between goods and services as stark, as is sometimes argued. Further work is needed to tease out the details of what fusion would amount to in practice and what advantages would flow from it.</li> <li>- The conditions may not exist for attempting significant architectural experiments; however, an exploratory exercise among governments, as well as other stakeholders, of arguments for augmenting compatibility between the two policy sets and practical ways this could be brought about would be worthwhile.</li> <li>- This exercise should take account of possible lessons from alternative approaches adopted by preferential trade agreements.</li> </ul>	<ul style="list-style-type: none"> <li>The working group might start its work by considering the following possibilities in which there is an identified gap: <ul style="list-style-type: none"> <li>- Identifying areas of trade law where the playing field might not be level between goods and services firms.</li> <li>- Bringing together international rules on investment in goods and services, as well as rules on the movement of people, taking into consideration the implications this would have in terms of extending multilateral disciplines to investment and people movement beyond those existing for services under GATS.</li> <li>- Bearing in mind possible risks associated with splintering trade rules along sectoral lines, consider the possibility – as has already emerged in the procurement field – of including both goods and services in some stand-alone agreements such as the ITA, the TFA, and an agreement dealing with environmental products as well as in possible future agreements in areas like cross-border data flows and e-commerce.</li> </ul> </li> </ul>

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Other suggestions for modifications to the GATS</b>			
<b>11. Launch a process to examine ways of accruing greater benefits from temporary cross-border movement of people supplying services.</b>	Short Term	<ul style="list-style-type: none"> <li>- GATS rules on the temporary presence can be strengthened.</li> <li>- Currently, temporary movement of persons under Mode 4 has not been the object of liberalizing commitments to the same degree as the other three modes. Governments have been reluctant to touch upon issues such as visas and work permits in the framework of a multilateral trade organization.</li> <li>- The experience of PTAs covering temporary movement of persons should be taken into account.</li> </ul>	<ul style="list-style-type: none"> <li>- Call upon WTO members to clarify GATS provisions in relation to how the Agreement covers processes and procedures related to visas and work permits.</li> <li>- Improve transparency in relation to national conditions, procedures and processes for issuing visas and work permits.</li> <li>- Strengthen regulatory cooperation between governments for managing the entry and stay of natural persons for the supply of services.</li> </ul>
<b>12. Call upon WTO members to examine various aspects of scheduling practices in the GATS with a view to improving existing arrangements.</b>	Medium Term	<ul style="list-style-type: none"> <li>- Improvements can be made on issues relating to GATS disciplines on scheduling as well as procedures and techniques in order to increase the consistency, depth, and clarity of scheduled commitments.</li> </ul>	<p>Areas to assess the desirability of change include:</p> <ul style="list-style-type: none"> <li>- Progressively switching to the adoption of negative listing in GATS schedules of specific commitments.</li> <li>- Working on a more standardized system of nomenclature for the scheduling of specific commitments.</li> <li>- Establishing a “roll-back and standstill” negotiating modality that could be applied horizontally to align items listed in schedules of specific commitments with <i>status quo</i> policy in order to eliminate “water” in commitments.</li> </ul>

## Annex 2: Members of the E15 Expert Group

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OF THE WORLD

# Rethinking Subsidy Disciplines For the Future

Policy Options Paper



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# Rethinking Subsidy Disciplines For the Future

Gary Horlick and Peggy A. Clarke

on behalf of the E15 Task Force on Rethinking International Subsidies Disciplines

January 2016

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## Note

The policy options paper is the result of a collective process involving all members of the E15 Task Force on Rethinking International Subsidies Disciplines. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Gary Horlick and Peggy Clarke were the authors of the report. While a serious attempt has been made on the part of the authors to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the authors. The list of group members and E15 papers are referenced.

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The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

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# Abstract

Subsidies are a critical instrument in the toolbox that governments use to achieve a variety of policy goals. In an increasingly interdependent world, addressing the negative externalities of subsidies while maintaining their market-correcting function and the policy space for development is an imperative from a sustainable development perspective. In light of the changes in the global economy and emerging social and environmental concerns, the present paper seeks to assess the adequacy of existing international subsidy disciplines and suggest possible areas for improvement and reform. Three groups of policy options are identified. First, revisit international disciplines by creating, under the WTO Agreement on Subsidies and Countervailing Measures, a narrowly

defined category of non-actionable subsidies with clear boundaries, as well as a category of subsidies subject to absolute prohibition or a presumption of prohibition. Second, the procedures for establishing, monitoring and resolving disputes for the various types of subsidies should be adjusted by strengthening the role of a neutral decision-maker while restricting the option for unilateral action. Finally, a key consideration in the field of subsidies is that of obtaining better data and measuring impacts. The establishment of an independent platform for data collection using common standards and definitions is recommended. Where appropriate, the paper seeks to identify gaps in priorities and concerns over subsidy disciplines between advanced and developing economies.

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Abbreviations	
ASCM	Agreement on Subsidies and Countervailing Measures
CVD	countervailing duty
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GHG	greenhouse gas
GVC	global value chain
LCR	local content requirement
OECD	Organisation for Economic Co-operation and Development
PGE	Permanent Group of Experts
R&D	research and development
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TiSA	Trade in Services Agreement
TTIP	Transatlantic Trade and Investment Partnership
WTO	World Trade Organization

# Executive Summary

In an increasingly interdependent world, addressing the negative externalities and beggar-thy-neighbour effects of subsidies, while maintaining their market correcting function, the policy space for development, and their role in delivering essential public goods, is an imperative from a sustainable development perspective. The international community has long attempted to address the concept of subsidies discipline, currently through the WTO Agreement on Subsidies and Countervailing Measures (ASCM). However, a fresh look at the issue is necessary. To this end, ICTSD, in partnership with the World Economic Forum, convened a task force of leading experts, as part of the E15 Initiative, to analyse the role of subsidies and the adequacy of international disciplines. Based on this analysis, the paper puts forward new directions for discussion and future policy implementation.

## Should Subsidies Be Disciplined?

For the purpose of this study, the concept of subsidies is broadly defined as a subset of government intervention (or inaction) in the marketplace. Industry-specific protective tariffs, safeguards, export taxes, input quotas and trade remedy tariffs are not addressed. More broadly, the discipline of regulatory action with subsidy-like effects is not treated.

While the ASCM provides some discipline on the use of subsidies to goods, there are almost no multilateral disciplines in services and the agricultural sector receives different treatment. This paper takes the view that subsidies for agriculture and services should be subject to the same (or similar) discipline as goods, even if remedies for services may need to be different.

The proposals in this paper stem from an assessment that the arguments for some disciplines on the use of subsidies are, on balance, stronger than the counterarguments. The arguments in favour derive from the following impacts amongst others: subsidies can distort trade and resource allocation, and lead to unfair competition; they can encourage behaviours proven to be destructive of the environment; and they may increase the development gap between rich and poor. The economic arguments against the implementation of disciplines on subsidies, widely viewed by governments as effective instruments to achieve a variety of policy goals, must nevertheless carefully be considered. Subsidies “may represent sensible policy responses to a range of market failures [...] and] the task of distinguishing the good from the bad is extremely complex as a practical matter. Existing subsidies disciplines do a poor job in this regard, and simple fixes are not apparent” (Sykes 2010).”

The paper thus considers some form of discipline as desirable, even though the type and extent of that discipline may vary depending on the type or purpose of the subsidy—e.g. measures that target subsidies that have a negative impact on the global commons as against subsidies that are distortive of trade. The underlying issue is how to evaluate (and measure) the impact of subsidies outside the border of the subsidizing government and on global public goods. Any discipline must recognize the positive as well as the negative. If one starts with the proposition that governments should have the policy space to provide subsidies as long as it does not cause adverse impact outside their territory or on the commons, then the question becomes how to determine whether there is impact and to what extent.

## Revisiting International Disciplines

In recommending reform and improvements in subsidies disciplines, a three-tiered approach such as that found in the existing ASCM is considered appropriate. A key concern in framing this categorization is that of establishing clear definitions and strict criteria for inclusion.

### *Non-Actionable Subsidies*

The first category would be composed of narrowly defined non-actionable subsidies (i.e. not subject to discipline, as envisaged in ASCM, Article 8, which expired) with clear boundaries. This would include safe harbours for subsidies that usefully address market failures or other externalities: subsidies to address climate change adaptation and mitigation as well as other environmental concerns (as long as the purpose of the subsidy is not to gain a commercial advantage); regional development subsidies for disadvantaged regions within a country; certain subsidies that target R&D activities beneficial to society at large in which private commercial incentives may be insufficient; and subsidies aimed at recovery from natural disasters and conflict.

### *Prohibited Subsidies*

The second category would consist of subsidies that could be subject to absolute prohibition or a presumption of prohibition (such as in the now defunct ASCM, Article 6.1). This would include subsidies that generate such negative externalities that they should be phased-out and prohibited. The ASCM already reflects a consensus that there exist certain forms of subsidies, the results of which are so harmful to external parties or economically undesirable that they should be banned (i.e. export-contingent and domestic content subsidies). There are other subsidies that have the potential to create significant harm to global

welfare. The following areas should thus be considered for additional prohibition purposes: locational subsidies designed to attract investment which may encourage a race to the bottom (both at a subnational and international level); subsidies that encourage the exploration, production or use of fossil fuels (while taking into account the impact of consumption subsidies on the poor); and other resource-depleting subsidies of the most egregious types that impact on the global commons (for example capacity-enhancing subsidies in fisheries).

### *Actionable Subsidies*

The third category would include all subsidies that do not fall neither into the non-actionable nor prohibited boxes and that consensus indicates may be permissible yet actionable. If it is demonstrated that others (or the sustainability of shared natural resources) are harmed by their use, recourse to remedy should be possible. The most likely type of process to be acceptable in this instance is one similar to that currently provided for in the ASCM, with adjustments to make multilateral disciplines more effective and unilateral disciplines (i.e. countervailing duties) less prone to protectionist leanings.

### *Subsidies Not Currently Covered by the ASCM: Are Services Different?*

Some disciplines on services subsidies should be established; especially in light of the increasingly prominent role of services in international trade. To date, negotiations under the General Agreement on Trade in Services (GATS) have failed to reach a consensus on this issue. In exploring the scope for disciplines, the definition of subsidy and potential remedy would have to be adjusted to account for the different nature of services trade and the diverse modes of delivery. The first step in this examination is the need for far better data allowing for a more informed mapping of the nature and sectoral incidence of subsidy practices and their use across country groupings.

## **Monitoring and Next Steps**

The procedures for establishing, monitoring and resolving disputes for the different types of subsidies categorized above would not necessarily be identical although there would be certain commonalities.

### *Who Decides?*

The ASCM takes a mixed approach. The multilateral dispute resolution process provided for in the WTO reflects the goal of having a neutral decision-maker determine whether members' interests have been harmed through the use of subsidies. The ASCM also allows for national decision-makers in the form of countervailing duty actions. Empirical evidence suggests that when the unilateral approach is taken there is an inherent tendency towards a protectionist bent. The following two options should thus be considered.

First, strengthen the role of a neutral decision-maker in the resolution of subsidies disputes. The advantage of a neutral decision-maker is that one can apply a broader definition of subsidy (coupled with high standards of proof). One possibility would be to establish a multinational

group of experts (e.g. the role originally envisaged for the independent Permanent Group of Experts as established under ASCM, Article 24). Another option would be to use expedited arbitration procedures using existing practices with some disputes subject to binding arbitration (on prohibited subsidies for example).

Second, eliminate or at least restrict the option for unilateral action. The ASCM provides for unilateral subsidy discipline actions and outlines rules for how they should be undertaken. The current system should at a minimum be adjusted to apply to only the narrowest definition of a subsidy. Countervailing duties should be limited to offsetting only the effect of subsidies in excess of the support received by competitors in the importing country. National decisions must be subject to a binding dispute resolution that is faster than the current system and more effective in reaching compliance.

### *How To Get There?*

Despite the general stagnation in WTO rules negotiations and the relative lack of interest in making major amendments to the ASCM in the ongoing Doha Round, the issue of changes in current international subsidy disciplines deserves renewed attention and effort.

Interpretation of the ASCM by the Appellate Body would appear unlikely to bring about major change. At first sight, no other organization covering most countries seems likely to tackle the issue. But this is misleading: it is probable that changes will be made in subsidy disciplines in the course of negotiations over climate change for example. Greater transparency would help. However, even widely publicized lists of subsidies have at best a mixed record in obtaining reform.

### *Data Collection*

A key consideration in the overall subsidies discipline debate is that of obtaining better data. The formal intergovernmental notification process has not produced the necessary breadth and depth of information about subsidies for a consistent set of reliable data that would permit more informed policy discussions and decisions. A recommendation is thus to establish an international consortium of universities and independent think tanks, supported by funding, that could develop a platform for data collection using common standards and definitions.

# 1. Introduction

The analysis and recommendations presented in this paper draw on a collective examination by a group of experts on the role of subsidies and the desirability of international disciplines. While we acknowledge that the international community has for a long time attempted to address the concept of subsidies discipline, currently through the WTO Agreement on Subsidies and Countervailing Measures (ASCM), a fresh look at subsidies is necessary, unconstrained by the ASCM or other systems that have developed. The examination is nevertheless informed by previous experiences.

This paper is the authors' conclusions drawn from that examination. We are aware that this is a much-ploughed field and that different conclusions can be reached. We hope that the think pieces commissioned for this project (listed in reference) and the authors' attempt to draw conclusions are of use as issues about subsidies are debated—and possibly agreed upon—at discussions and negotiations around the globe. Each of the issues discussed in this paper already has a full bookshelf (or its digital equivalent) with far more nuance than is possible here. Yet our intention is to suggest new angles and possible directions for future discussion and policy implementation.

Subsidies are a critical instrument in the toolbox that governments use to achieve a variety of policy goals. These include promoting certain sectors, attracting investment, fostering economic transformation, developing disadvantaged regions and facilitating socio-economic adjustments, to list a few. The way in which subsidies are allocated contributes to shaping global consumption and production patterns, as well as income distribution and the use of natural and other resources. Critics often point to the inefficiencies and economic distortions they create, their perverse distributive consequences, and the negative impact they can have on the environment by lowering prices and exacerbating their effect (or lack thereof) on externalities. At the same time, subsidies can play a key role in addressing market failures—with regards research and development for example—and advancing public policy objectives, such as providing access to energy for the poor, supporting the livelihood of small farmers or delivering essential public goods.<sup>1</sup>

In an increasingly integrated and interdependent world, addressing the negative externalities and beggar-thy-neighbour effects of subsidies, while maintaining their market-correcting function, the policy space for development, and their role in delivering essential public goods, is a clear imperative from a sustainable development perspective.

<sup>1</sup> Although those objectives can be a “smoke screen” for, inter alia, subsidizing large farmers.

# 2. Should Something Be Done About The Use of Subsidies?

Why start over, with blank sheets of paper? The world has changed since the early 1990s, with new public and private actors, new structures, especially global value chains, and new or renewed challenges (e.g. climate change, declining fish stocks, the revival of industrial policy). For the purpose of this examination, we start with a concept of subsidies broadly defined as a subset of government intervention (or inaction) in the marketplace. While we acknowledge that there may be instances of private subsidies, in considering international disciplines we concentrate on government intervention in the flow of the market (which may include government inaction in certain instances). So far, governments have not defined grants of monopoly rights (e.g. single-desk marketing boards, intellectual property protection, road and other concessions) as possible subsidies, although the large cash payments to monarchs for monopolies in the past hint they have monetary value. Similarly, industry-specific protective tariffs, safeguards, export taxes, input quotas and trade remedy tariffs are not considered subsidies, despite the large political investment in obtaining some of them.<sup>2</sup> Both would seem quantifiable, but we do not plan to address them here, as it would make the scope of this project overwhelming.

More generally, the subsidy-like effects of regulatory action (or inaction) have not been treated as a subsidy; at least since the 1982 US steel countervailing cases (possibly because the US Administration had granted the US steel industry special tax treatment, special environmental rules and a special import control regime as part of the 1980 presidential election). Attempting to discipline government regulatory action (or inaction) is thus best left to another study, as the current WTO regime of GATT plus technical barriers to trade (TBT) plus sanitary and phytosanitary (SPS) measures seems to be overtaken (at least for the moment) by the talks about regulatory convergence in the Transatlantic Trade and Investment Partnership (TTIP).<sup>3</sup> That leaves open the question of where to put such intervention as maintaining input prices at home lower than their export prices.

While currently the ASCM and a few other agreements provide some discipline on the use of subsidies to goods, there are almost no multilateral disciplines on the use

of subsidies for services. Agricultural subsidies receive different treatment from subsidies to the manufacturing sector; however, the reason for different treatment lies more in historic political concerns than in current economic reasoning.<sup>4</sup> We think that subsidies for agriculture (Josling 2015) and services (Sauvé and Soprana 2015, 10-11) should be subject to the same (or similar) discipline, even if the remedy may need to be somewhat different for service subsidies.<sup>5</sup>

## 2.1. Arguments for Disciplining Subsidies

On balance, while we acknowledge that there are good arguments against disciplining the use of subsidies (see section 2.2), we believe the arguments for some disciplines are stronger. Subsidies can potentially or actually distort trade, competition and investment decisions. Some subsidies have encouraged behaviours that have proven to be highly destructive of the environment (e.g. leading to over-fishing of ocean-going fish stocks, or leading to increasing emissions of greenhouse gases). Subsidies can also lead to massive waste, inefficient use of scarce resources and, possibly, even subsidy wars in certain industries or specific situations, while the benefits of the subsidies are captured by a few at the expense of the many. The use of subsidies can increase the development gap between rich nations (those that can afford to subsidize) and poor nations (those that cannot). The race to attract investment can lead to negative effects, including non-trade effects (such as unemployment or the destruction of non-renewable natural resources). Moreover, there are already a variety of subsidy disciplines in place, which implies an international consensus that some subsidy disciplines are beneficial. Therefore, we conclude that some form of subsidy discipline is desirable (or at least likely), even though the type and extent of that discipline may vary depending on the type or purpose of the subsidy. For example, if the reason for disciplining a certain type of subsidy is because it has a negative impact on the global commons, the form of discipline might be different than when a subsidy is distortive of trade (or harmful to competitors).

<sup>2</sup> The US in 1984 stated that industry-specific GATT-legal tariffs are not countervailable subsidies (Certain Steel Products from Australia, 49 Fed. Reg. 8,657 (Mar. 8, (1984)), then disagreed with itself in 1986 in order to countervail Canadian softwood lumber exports, (Softwood Lumber from Canada, 51 Fed. Reg. 37,453 (Oct. 22, 1986))—which eventually led to the pre-emptive WTO panel ruling seeming to hold that regulatory action is not countervailable (United States – Measures Treating Export Restraints and Subsidies, Panel Report, WT-DS194/R (adopted 25 Apr. 2001)).

<sup>3</sup> See the policy options paper produced by the E15 Task Force on Regulatory Systems Coherence.

<sup>4</sup> A set of recommendations specifically addressing agricultural subsidies can be found in the policy options paper produced by the E15 Expert Group on Agriculture, Trade and Food Security.

<sup>5</sup> For example, tariffs such as countervailing duties which are applied when goods cross a border do not apply to services, but one could imagine an offsetting tax being applied if a neutral procedure and measurement methodology were to be devised.

## 2.2. Arguments against Subsidy Disciplines

There are economic and policy arguments against the implementation of subsidy disciplines. Subsidies are widely viewed by governments as effective policy tools and may be less trade destructive or distortive than the likely alternatives, such as higher tariffs.<sup>6</sup> The essence of the economic case against subsidies discipline has been succinctly described by Sykes (2010):

Subsidies *may* create negative international externalities and distort global resource allocation. But they may also represent sensible policy responses to a range of market failures or play a useful role in addressing income inequality. The task of distinguishing the good from the bad is extremely complex as a practical matter. Existing subsidies disciplines do a poor job in this regard, and simple fixes are not apparent. Subsidies disciplines also invariably ignore the other side of the ledger (taxation and regulation), so that the *net* impact of government on competitiveness is unobserved and likely unobservable in practice.

He further argues that:

The rules that purport to distinguish permissible from impermissible subsidies are just incoherent. They rely on arbitrary criteria, distinctions that elevate form over substance, and on the wrong analysis of government measures that inevitably masks the full effects of government activity on business enterprises.

Finally, there is a concern that disciplines are (or would be) applied disproportionately to developing countries because the cost of implementing such disciplines is more easily borne by the developed countries that can bring greater resources.

## 2.3. Evaluating the Cross-Border Impact of Subsidies

Despite the arguments against discipline, some subsidies disciplines have worked reasonably well. An example includes the WTO prohibition against export-contingent subsidies (with limited exceptions for developing countries and a major exception with respect to export credits for mainly developed countries). In addition, the massive waste of public resources on often ineffective subsidies during the recent financial crises, and the use of “factory stealing” subsidies to influence investment decisions, suggests that at least some degree of discipline is necessary and that improvements to existing disciplines can be made. This would extend to subsidies that help deplete scarce and non-renewable natural resources and other global commons, even if the economic impact stays within the country. Therefore, on balance, we think that certain forms of subsidies discipline are desirable, even if perfect disciplines cannot be developed.

Nevertheless, the “no-discipline” arguments raise good points and we need to be very careful regarding the nature of the disciplines and how they are applied. This is particularly true with respect to the big vs. small economy disparities, discussed below (see Box 2). Even if subsidies should be disciplined, the discipline only applies to subsidies that have adverse effects outside the territory of the government giving them. Moreover, subsidies can have many positive effects, both domestically and across the border, and any discipline must recognize these positive effects as well as the negative.

The underlying question is how to evaluate, and perhaps measure, the impact of subsidies outside the borders of the subsidizing government. If one starts with the proposition that governments should have policy space within their own territory to give subsidies as long as it does not cause impact outside that territory, a concept already tried in the 1979 GATT Subsidies Code, Article 11.3, then the question becomes how to determine whether there is impact and by how much.<sup>7</sup> Thinking in the late 1970s and early 1980s (when many of the current rules originated) reflected a concern with government assistance potentially reducing marginal costs within perfect competition. This has now been matched by a concern over whether governments are assisting companies to reduce their fixed costs. The work of Melitz, Levinsohn and others may provide a framework for analysing whether these effects are in fact occurring (Melitz 2003, Petrin et al. 2003, Levinsohn et al. 2004).

Much greater use of current methods of economic analysis for subsidies (as is increasingly the case in other WTO disputes) should be tried. If it were possible to obtain the necessary data, at least in large economies, it would be very interesting to go further than measuring impacts and try to identify if there are different impacts from different types and sizes of subsidies. In addition, at least in industries with imperfect competition, game theory could be explored as a tool for analysing subsidy impacts. Finally, if some priorities are considered particularly important (e.g. the need to tackle climate change), could harm be presumed, at least in a rebuttable manner, for some subsidies (along the lines of the current ASCM, Article 6.1)?

<sup>6</sup> Subsidies may indeed target market failures and may, in some cases, represent the best policy instrument for addressing distortions. See, for example, Johnson (1965); and (Bagwell 2006). They may be especially important as a tool for economic development in developing countries, as argued for example by Dani Rodrik.

# 3. Policy Options: Revisiting International Disciplines

Arguments exist for and against treating subsidies intended for different purposes differently. Certain subsidies can usefully address market failures or other externalities, creating a public good. Economic logic suggests that subsidies that fall under these categories should be treated separately and addressed in a *sui generis* manner rather than being subject to a generic form of discipline. Using existing terminology on subsidies disciplines, these would be considered non-actionable (“permissible”) subsidies as long as certain criteria were met. The categories should be defined narrowly to avoid creating loopholes that eviscerate any subsidy disciplines that would otherwise exist.

In contrast, there are other forms of subsidies that create such negative externalities—e.g. distorting trade, harming the economic development of other countries, damaging the environment (including within the country)—that they should be banned. The difficulty lies in establishing clear definitions of these types of subsidies and strict criteria for determining when the negative externalities are sufficiently overwhelming. As can be seen in at least some of the categories proposed below, the externalities at stake may go beyond trade distortion; they may also reflect negative impact on the global commons.

In examining the overall issue, we find a three-tiered approach to subsidy discipline, such as in the ASCM, to be reasonable. Permissible subsidies—which would be narrowly defined—would not be subject to discipline as long as they fell within that narrow definition. The category of prohibited subsidies—i.e. those whose negative effects outweigh other considerations (such as subsidies that encourage fossil fuel production and consumption)—would be defined more broadly to include actions beyond the current ASCM subsidy definition that have similar economic impact. These would be subject to absolute prohibition or, perhaps, a presumption of prohibition such as in the now defunct ASCM, Article 6.1 (which defined where “serious prejudice” resulting from a subsidy was deemed to exist).

Finally, all other measures would fall within the category that the ASCM calls “actionable,” as long as an impact outside the country (or to a “global good,” perhaps even within the country) is demonstrated. These would be subject to disciplines, possibly similar to the existing ASCM approach with some adjustments, to make multilateral disciplines more effective and unilateral disciplines (countervailing duties) less prone to protectionist behaviours (or even abolished, as explained in section 4.1 below). In addition,

governments should be able to “club together,” either formally or informally, to limit their own subsidies, even those with no cross-border effects. The EU rules applicable to state aid and the OECD export financing arrangements can be viewed in this light.<sup>8</sup>

## 3.1. Non-Actionable Subsidies

Possible types of non-actionable subsidies are discussed in this section.<sup>9</sup> We also address the difficulties and issues to consider in defining such subsidies and controlling their use.

### 3.1.1. Subsidies to address climate change and similar environmental issues

It is widely acknowledged that the Earth is experiencing a potentially profound period of climate change. This is leading to higher temperatures, rising seawaters, and more erratic and extreme weather events. The strong likelihood is that these changes will continue throughout the century. As a result, territories may need assistance to adapt to evolving climate patterns and rising sea levels. It may also be useful to support efforts that lessen the rate of increase of this change, such as a reduction in greenhouse gas emissions (both well described by Espa and Rolland (2015)). There is currently an initiative by a group of 17 WTO members to eliminate tariffs on a negotiated list of environmental goods—perhaps a first step would be the favourable treatment of subsidies targeted at the consumption of those goods as well.

Any safe harbour for climate change or other environmental subsidies, however, should not be used to enable one country to gain a commercial advantage over another. For example, many countries are currently racing to develop renewable energy capabilities. Subsidies that help industries use environmentally preferred energy sources might be good public policy (to lower the cost of green energy below that of fossil fuels). But subsidies directed at aiding one country’s industry manufacturing the technology (e.g. solar panels or wind turbines) over another country’s might be treated no differently than any other subsidy to the manufacture of goods. The inevitable “boundary issues” could be handled by a mix of “hard” and “soft” law, such as the discussions in relevant WTO committees or the role originally envisioned for the Permanent Group of Experts (PGE) in the ASCM—i.e. reviewing mandatorily pre-notified “permissible” subsidies under Article 8 as originally drafted.

<sup>8</sup> The authors are unaware of any significant discipline on “domestic” subsidies to have occurred in regional trade agreements. For the limited disciplines on countervailing duties, see Table 1 in: Kasteng, Jonas, and Camilla Prawitz. 2013. Eliminating Anti-Dumping Measures in Regional Trade Agreements. National Board of Trade of Sweden.

<sup>9</sup> The ASCM, when negotiated, recognized the idea that for some categories of subsidies the good outweighed the potential for trade distortion by including Article 8. However, this experiment in the “Identification of Non-Actionable Subsidies” ended in 1999 when the five-year term of Article 8 expired pursuant to the sunset clause in Article 31. Article 8 explicitly referred to three narrowly defined areas: R&D support; assistance to disadvantaged regions; and adaptation to new environmental requirements.

### 3.1.2. Regional development subsidies

Many countries, especially developing countries, experience very high domestic disparities in the cost of investment in different regions and extreme variations in income and employment opportunities in those same areas. A degree of financial redistribution may be rational, as well as politically inevitable. Some form of safe harbour for regional development subsidies should thus be considered (as well as a *de minimis* level). To prevent abuse, such subsidies should be limited to doing no more than offsetting the additional cost of investment in that region. Another possibility is to give preference to the poorest countries (using metrics such as the United Nations or World Bank indices of least developed countries). The safe harbour would also need to be limited to those regions of a country where the costs of investment and doing business were X percent above the norm for the country at issue (other metrics could be considered such as regional unemployment rates). The difficulty lies in how such costs are to be measured (and which measure of cost is relevant). An objective baseline would need to be established. Numerous metrics that measure the relative costs of investing and doing business within individual countries exist, which perhaps could be adapted to this purpose.

More broadly, the role of subsidies in economic development underlies nearly all the topics in this paper and is better discussed by experts in trade and development. Nonetheless, ASCM, Article 27, has an objective structure for inclusion and graduation that could be a more useful starting point than the subjective self-selection found elsewhere in the WTO.

### 3.1.3. Research and development subsidies

Research and development (R&D) is an area in which some incentive may be useful to overall development. With some R&D, a company cannot expect to capture more benefit than its cost plus profit. As a result, companies tend to invest less in R&D than is desirable for society as a whole. A safe harbour should thus be established for certain R&D subsidies. Any safe harbour, however, would need to be carefully crafted to avoid subsidizing R&D that would occur without the subsidies. Moreover, since the public would be funding such R&D (through the subsidies), the safe harbour could require that the results of the R&D be made publicly available to any agent who seeks to use it. While this requirement may act as a disincentive, there may still be an advantage to the firm conducting the research. Such a requirement would also serve as an incentive to companies to fund through commercial mechanisms some R&D they would otherwise fund with a subsidy, lest they be unable to retain the results of the R&D for their exclusive use. But it would run the risk of companies using government funding only for the least promising research. It may also favour richer countries over poorer ones due to their greater availability of resources to subsidize R&D. The answers to

the questions raised by Maskus (2015) about innovation suggest new ways of looking at the problem, especially through openness to competition. This may be a particularly good area for mandatory periodic review (without the draconian sunset in ASCM, Article 31, that eliminated Article 8).

### 3.1.4. Natural disasters

In recent years, the world has experienced natural disasters of such magnitude that recovery from them requires extraordinary investment. In these instances, perhaps there should be a safe harbour for subsidies provided to allow the industry or economy affected to return to its pre-disaster state.<sup>10</sup> Any such safe harbour would need to be time restricted, with metrics established to determine when the recovery period has ended (perhaps using pre- and post-disaster employment and output levels as baselines). The safe-harbour would also need to be very specific on the magnitude of the natural disaster that would qualify for such treatment. The difficulty lies in narrowly crafting the safe harbour to permit subsidies to restore what was destroyed, without covering the cost of expanding or modernizing production. Metrics could possibly be developed by drawing on the experience and efforts of the UN Office for Disaster Reduction with respect to risk reduction in determining when the disaster is of sufficient magnitude to qualify for a safe harbour on recovery assistance.

### 3.1.5. Other disasters

If subsidies are necessary to recover from natural disasters such as earthquakes and tsunamis, what about man-made disasters such as war? The economic disruption caused by these disasters can induce further social and political instability. Therefore, a safe harbour (similar to that for natural disasters) should be recognized for the time-limited use of subsidies to allow an economy to recover after certain man-made disasters. The same concerns and considerations discussed above in the context of natural disasters would also apply to crafting this safe harbour, perhaps with a return to general subsidy rules over time.

## 3.2. Subsidies to be Phased-Out or Prohibited

The ASCM reflects a consensus (at least when it was drafted) that there exist certain forms of subsidies the results of which are so restrictive to trade, harmful to the economic development of third countries, anti-competitive, or otherwise economically undesirable, that they should be banned. This is reflected in the prohibition of subsidies that are contingent upon the exportation (or anticipated exportation) of the subject merchandise, and subsidies that are contingent upon the use of domestic over imported goods.

<sup>10</sup> Under the ASCM, these subsidies could be considered regionally specific and thus actionable, although in practice this has not occurred. The Agreement on Agriculture, Annex 2(8), on non-actionable subsidies provides for payments for relief from natural disasters with criteria outlined for eligibility and compensation.

It can be argued that on an overall economic basis export subsidies have the opposite of the presumed effect—reducing the terms of trade for the subsidizing country and improving the terms of trade for the rest of the trading community as a whole (Sykes 1989). Subsidies that require the use of local content, on the other hand, can be argued to result in the deterioration of the terms of trade for the countries trading with the subsidized country. While local content requirements (LCRs) enable governments to increase the welfare of their local input suppliers (via increased production, sales or employment), they do so at the expense of competing suppliers in other countries (externalizing the harmful effects of trade). LCRs also harm industries, including in the jurisdiction imposing the LCR, that compete with the subsidized inputs. For these reasons, the ASCM prohibits the use of such subsidies.

There are other subsidies and government interventions in the marketplace that have the potential of creating similar negative externalized effects, or of creating such harm to global welfare, that they should be prohibited. Because the negative effects are externalized (or at least spread globally) rather than felt mostly among the relevant government's constituency, there is little internal political incentive for the government to act for the global good. Therefore, disciplines on such actions may need to come from multilateral processes.

Mindful of the economic counter-arguments, we thus suggest that the following areas be considered for subsidy prohibition purposes, and that the definition of subsidy in these instances be expanded from that found in the ASCM to include other forms of government intervention in the market that have similar economic effects as subsidies—for example waivers of regulations imposed for environmental, labour or safety reasons. At a minimum, such subsidies should be subject to soft law disciplines, such as codes of conduct, even if outright prohibition is not possible.

### 3.2.1. Locational subsidies

Locational subsidies cover a wide spectrum of actions designed to attract investment (in goods and services) from elsewhere to the territory of the authority providing the subsidy. Such locational subsidization can lead to wasted resources. They are pervasive in the United States, in particular at the state and local levels, with estimates ranging into the tens of billions of dollars a year.<sup>11</sup> In practice, virtually no significant investment is made in the US, either by foreign or local investors, without some form of locational subsidy (which the recipients often increase by starting false competitions between two or more sub-federal territories). The practice is widely recognized as a bad idea (waste of resources), and there have been sporadic attempts by subsets of states to stop the “arms race” (and similar anti-poaching clauses among Canadian provinces and Australian states, as well as EU enforcement against some member

state subsidies). Such agreements in the US rarely survive even the first tempting possibility.<sup>12</sup>

While theoretically US government policy-makers, particularly in the Treasury and the White House Council of Economic Advisors, should strongly support the concept of discipline, politically these practices are probably untouchable because they are seen as the main tool of economic development at the state and local levels. Local politicians would be reluctant to surrender this policy tool because doing so would deprive them of a politically popular practice. As many federally elected officials start their careers as local representatives, they are sympathetic to the local level desire to retain this policy space. Other countries, such as Canada and EU members, also face competition among their sub-federal jurisdictions that result in the use of locational subsidies, with effects similar to the US. These subsidies can be also used to “poach” investment across national boundaries.

Locational subsidies, particularly within a country, might originally have had some economic development reasoning (although, perversely, the poorest jurisdictions end up giving the most money to companies), but most of that has long since disappeared. Companies now use them in a purely cynical exercise to extract money from governments or, even worse, to eliminate regulatory requirements (e.g. environment, labour, safety). Because the most important subsidy offered by US states and municipalities are holidays from taxes that support local education, they may well be self-defeating. Nevertheless, the states and localities find it impossible to unilaterally disarm in the subsidy battle. An international prohibition of such subsidies would be beneficial to all, by providing political cover for an action that would appear to make economic sense. Failing that, they could be presumed to cause the adverse effect necessary for discipline, along the lines of the defunct ASCM, Article 6.1.

Locational subsidies cover a wide spectrum, ranging from explicitly described subsidies to attract outside investment to almost any government action or inaction (e.g. loosening regulatory controls) that will attract industry (since politicians will learn to avoid the explicit subsidies if they are banned). The difficulty thus arises in defining a locational subsidy with enough specificity to be identifiable, but also sufficient generalization to capture a range of locational investment incentives or permissible regional development subsidies. One possible definition would be: subsidies dependent on a specified company building a new or expanded facility; or, subsidies dependent on a target company staying in an existing facility for a period of time (or indefinitely).

In addition, because there are a number of practices that can have this effect yet fall outside of the ASCM's subsidy definition, it may be desirable to employ a broader definition of the term to include other government actions that

<sup>11</sup> The website Subsidy Tracker at [www.goodjobsfirst.org](http://www.goodjobsfirst.org) offers numerous examples in the US.

<sup>12</sup> For example, a formal written compact signed by New York, New Jersey, and Connecticut fell apart when the three states competed for the headquarters of Mercedes Benz; which is now leaving the “winner,” New Jersey, for Atlanta, Georgia.

have a similar effect, such as regulatory waivers, to avoid detrimental competition to attract business. The definition would encompass subsidies otherwise permitted, such as environmentally desirable or regional development subsidies, when those subsidies are used for “factory stealing.” It would also include subsidies provided by all levels of government. Research is needed to see how these issues have been handled in federalized systems worldwide.

### 3.2.2. Fossil fuel subsidies

This category consists of subsidies that encourage the exploration, production or use of fossil fuels. One problem with such subsidies is that they encourage the depletion of a non-renewable natural resource for which unforeseen uses may be found in the future. At the same time, use of these resources leads to greater greenhouse gas (GHG) emissions. They therefore encourage the production and use of substances in a manner that can lead to lasting negative environmental (and potentially economic) consequences globally. The issues surrounding these subsidies are similar to the “commons” concerns discussed in Section 3.2.3 below.

An immediate stand-alone (phase out and) prohibition of fossil fuel production subsidies should be pursued, leading to an eventual ban on all fossil fuel subsidies while taking account of the impact of consumption subsidies on poor people (although much of the benefit often goes to wealthier consumers with more cars, larger homes, etc.). First steps could include better notification and peer review (within the OECD, for example, although it may be necessary to go beyond government-based notifications as discussed in section 4.6).

Climate change is a high priority global problem that cannot be solved solely at a national level. Fossil fuel subsidies can include government action or inaction, which makes investment in production, distribution or consumption more economically attractive than otherwise, with the adverse effect presumed. Enforcement can be through the “normal” mechanisms described in section 4 below, and with reverse notification by governments or private parties. Remedies should not allow countries to “buy their way out” with cash, tariffs or other compensation (as is possible in WTO disputes).

### 3.2.3. Other resource-depleting subsidies

At issue here is what has been called the tragedy of the commons. As identified by Garrett Hardin (1968), citizens acting independently and rationally according to their individual self-interest will behave contrary to the interests of the whole by depleting common resources. Examples of commons include fish stocks, forests, air, water and biological diversity. The effect of subsidies on over-fishing, for example, has been widely studied (OECD 2006; and UNEP 2011). Because subsidies for environmentally harmful

economic activity enhance the likelihood that individual countries will seek to externalize the costs of that depletion, this is an area that may need specific and strong disciplines. The fossil fuel subsidies addressed above also fall under this category.

Nevertheless, there are several considerations in taking such an approach. First, one must be careful not to define the category too broadly. Another difficulty is how to identify subsidies of this kind. There are many different forms these subsidies can take, with differing effects on the commons, local economies and development. For example, the Gordon-Schaefer model adapted by Sumaila et al. (Tipping 2015) shows that some fishing subsidies increase fishing effort and direct costs. Therefore, the requisite discipline for different categories of issues and impacts related to the commons will vary.<sup>13</sup>

Disciplines could include a prohibition of the most egregious subsidies—those that are most likely to expand the range of commons-harming production. For example, in the fisheries sector, subsidies to capital costs, variable costs and price supports (unaccompanied by production restrictions) are among those having the greatest negative impact (UNEP 2011). Under this approach such subsidies would be prohibited.

We would propose a combined approach to disciplining such subsidies: a hard law prohibition of specific types of subsidies that are most likely to increase over-production or otherwise encourage the expansion of resource-depleting activities, combined with a recognition that most other subsidies would be actionable (i.e. subject to discipline if harm to another country’s economic interests can be demonstrated). It may be that for particular activities there are subsidies that encourage desirable economic behaviour—such as the scrapping of fishing vessels under certain conditions (e.g. to prevent reuse or replacement for fishing). If such is the case, these subsidies could be placed in the permissible category.

These hard law approaches should also be accompanied by soft law approaches. For example, in industries where access to the resource is within an individual country’s control (e.g. fishing rights in territorial waters or the right to harvest lumber within the country’s borders), agreements to subject access to strict environmental controls could be established—this could include catch limits for fishing boats and sustainable forestry requirements for lumber.

If certain forms of subsidies are prohibited as suggested, then a process needs to be developed wherein challenges to a country’s provision of prohibited subsidies can be addressed. Perhaps the best approach is binding arbitration, with a requirement that all subsidies found to have been provided must be terminated and those already paid out be returned with interest.

<sup>13</sup> For recommendations specifically tailored to fishing subsidies see the policy options paper produced by the E15 Expert Group on Oceans, Fisheries and the Trade System.

### 3.2.4. Export-contingent subsidies

There is a long history of identifying such subsidies as harmful. While on a macroeconomic basis such subsidies bring costs to the country of provision, theoretically by lowering the price of the exports and therefore the revenue earned from such exports, while benefitting the consumers of the exported goods abroad (Sykes 1989), on a microeconomic level they harm those industries that compete with the subsidized goods. As such, export subsidies are frequently viewed as the form of subsidy that has the most distortive effect on trade and they have consequently long been prohibited in one form or another. The ASCM has reduced, if not eliminated, the use of export subsidies by the larger trading countries. It is our view that such discipline should stand. On the whole, the procedures and remedies already in place appear to be adequate with respect to export subsidies.

### 3.2.5. Domestic content subsidies

The ASCM was the first agreement to prohibit the provision of subsidies, receipt of which would be contingent on the use of domestic over imported goods. “Domestic content” subsidies distort cross-border trade by restricting imports and they can reduce the efficient allocation of resources and stifle innovation. Therefore, there are good grounds for prohibiting these types of subsidies, yet there are problems with the existing approach.

First, WTO panels and the Appellate Body have interpreted this prohibition narrowly, finding that a domestic content requirement is acceptable if it could be satisfied through labour and services. But there is nothing inherently less trade distortive in requiring the use of domestic services than there is in requiring the use of domestic goods. With the increasing growth of trade in services globally, a prohibition limited to the cross-border trade in goods is out-dated. Second, it is fairly simple to have an implicit local content obligation without making it explicit. Such an implicit condition is difficult to discipline, as discussed in section 4.2 below.

### 3.2.6. The legacy of Article 6.1 and Annex IV of ASCM

Article 6.1 of ASCM created a presumption of prohibition for certain horizontal types of subsidies (e.g. thresholds above 5% of a product’s value, operating losses, debt forgiveness), with some details in Annex IV. That may be a useful negotiating tool for increasing discipline, although it may be too blunt an instrument for the different areas highlighted in this paper. As with Article 8 on non-actionable subsidies, Article 6.1 was rarely used and expired in 1999 via a sunset clause. For subsidies which are agreed to be undesirable, it represents a possible softer approach to prohibition and is perhaps more easily achievable as a first step.

## 3.3. Are Services Different?

While Article XV of the WTO General Agreement on Trade in Services (GATS) provides for negotiation on the appropriateness of subsidy discipline, to date these negotiations have been unable to reach consensus on whether disciplines should be in place or what form they should take. As with trade in goods, there are arguments for and against the use of subsidies in services. Many developing countries are concerned that the main providers of subsidies are developed countries with more resources to offer and that those subsidies hinder the ability of developing countries to enter service sectors. At the same time, many countries (developing and developed) wish to maintain “policy space” to “nurture” domestic service providers. Thus, subsidies discipline could act as a barrier to development. Another concern is that services subsidies potentially have a multiplier effect, given that the production, distribution and transportation of traded goods is dependent on services. Finally, subsidies in the service sector (as with subsidies to goods) can have negative environmental effects. For example, subsidies to the tourism industry could lead to the over-exploitation of natural resources (Benitah 2005). In contrast, there are also concerns that discipline might prevent the use of subsidies even where the effect is either trade neutral or used for goals other than to incur a trade advantage. These could include subsidies applied to correct market imperfections arising from high entry costs or difficulties in access.

In the course of negotiations in the 1990s in the Working Party on GATS Rules, various countries suggested that a definition of subsidy extending beyond the “financial contribution” requirement of the ASCM would be appropriate for any services discipline. Yet they also expressed concern with carefully delineating how “injury” or “harm” from another country’s services subsidies would be determined.<sup>14</sup>

The role of services in trade has been especially prominent since the expansion of global value chains (GVCs). As Hoekman (2015) explains, this suggests the need to look at goods and services together, perhaps initially under a plurilateral arrangement.<sup>15</sup>

In sum, the scope for some form of services subsidies discipline should be explored. This should comprise further discussion on whether the definition of a subsidy should be broadened beyond that of “financial contribution” to include: the provision of monopoly rights and other restrictive trade practices that can be shown to exert harmful effects on trade and investment in services; and, as Sauv e and Soprana (2015) propose, domestic regulatory actions with subsidy-like properties. However, given the likely controversial nature of the issue, any discipline that is imposed should be multilateral in nature with the question of harm or injury to be determined by a neutral panel that

<sup>14</sup> See, for example, Communication from Chile: The Subsidies Issue, S/WPGR/W/10 (2 April 1996).

<sup>15</sup> Article 1.1(a) of ASCM defines a subsidy to include the provision of goods or services at less than adequate remuneration.

includes at least one expert in the sector under review. A problem with developing effective disciplines for subsidies to services is the variation in methods for delivering services as reflected in the four modes established in the GATS for services commitments. Perhaps discipline could be established along the same lines, either as part of the initial commitments or through additional commitments under GATS, Article XVIII. The first step, as Sauv  and Soprana note, is the need for much better data allowing for a more informed mapping of the nature and sectoral incidence of subsidy practices and their differing use across country groupings. Absent further progress at the WTO, the Trade in Services Agreement (TiSA) process could be enlisted to gather this data as part of the negotiation or thereafter.

### 3.4. Everything Else

The subsidies that do not fall into either the non-actionable or prohibited boxes outlined in sections 3.2 and 3.3 are subsidies that consensus indicates may be permissible yet actionable. If it is demonstrated that others (or the public good) are harmed by their use, recourse to remedy should be possible. The most likely type of process to be acceptable in this instance is one similar to that currently provided for in the ASCM (as discussed in section 4 *infra*).

#### Box 1: Revisiting the Concept of Specificity

##### A. The Benefit Debate

It may be worth revisiting the debate in the early 1980s about whether the test of a subsidy should be if there is a “benefit” to a recipient or a “cost” to a government. It is questionable how serious the debate was (when the EU began advocating the “cost to the government” test in defence of countervailing duty (CVD) cases in the US, its own countervailing duty regulation used the “benefit to the recipient” test for soft loans for example).<sup>16</sup> However, at a deeper level, this debate requires a consideration of what is the “effect” of the subsidy. This recalls the argument that government should be left policy space in general to subsidize as long as there is no underlying effect outside its own country.<sup>17</sup> Is there a universe of government activities with no effect outside the border?

The concept of “specificity” (if not its current application by national authorities or the Appellate Body) tries to capture this thought: are there government activities that would not affect comparative advantage within its own territory? At the other end of the spectrum: are there “benefits” which enterprises receive that are not readily

captured or calculated? The alleged US government subsidy to Fannie Mae, from the (unwritten but expensive) implicit or assumed guarantee by the US Treasury was readily calculated (but not without controversy). Could subsidy disciplines be applied to designated “national champions” such as the President’s son’s automobile company in Indonesia beyond identified financial assistance because of the designation itself?<sup>18</sup> Once again, specificity may be a useful tool. If the President has a lot of relatives running national champion companies, does that sufficiently dilute or eliminate the impact on comparative advantage within the country? If China’s catalogue lists more than 400 industries in almost every possible area, are they all national champions?<sup>19</sup>

##### B. Specificity – Is this Requirement Still Needed?

Specificity arose in the context of US countervailing duty law (Horlick 2004). It was viewed as necessary on at least two grounds. First, broadly distributed subsidies were thought not to favour a specific industry (i.e. to distort comparative advantage within a country).<sup>20</sup> Second, in practice, it was necessary to filter out subsidy allegations that would affect virtually all products, including normal government functions such as roads, schools, police protection and so on (especially since, at the time, no injury test was required under US countervailing duty law against most countries, which meant that one finding of subsidy could be replicated simply by copying the last decision and applying it to every other product from that country).

It is worth re-examining the issue as part of a wholesale reassessment of subsidies.

Specificity has several problems:

- There is no obvious “bright line” test for specificity beyond “you know it when you see it.” This leaves open the possibility of biased application, such as the politically motivated change of position on specificity from Softwood Lumber I to Softwood Lumber II when the facts had not changed, as well as the Department of Commerce’s finding (upheld by the Appellate Body) that more than 400 industries in China are specific because they are specifically named in a list—in contradiction to the Commerce regulation (19 CFR 351.502(d)) that agriculture by itself is not specific. This problem can be solved in good part by a neutral decision-maker with experience in cases.

<sup>16</sup> Council Regulations (EEC) 3017/79 of 20 December 1979, 1979 O.J. (L339) 1-14; as amended by Council Regulation (EEC) 1580/82 of 14 June 1982, 1982 O.J. (L178) 9.

<sup>17</sup> This is quite separate from whether special policy space might be needed for certain types of subsidies, for example where the effect is on a global commons.

<sup>18</sup> Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54, 55, 59 and 64/R (adopted 23 July 1998).

<sup>19</sup> See the Appellate Body ruling in United States – Definitive Anti-dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB (adopted 25 Mar. 2011)

<sup>20</sup> EU competition/state aid law at the time (but not EU countervailing duty law) had a similar concept, “selectivity.”

- Most problematically, politicians, business people and lawyers facing the specificity doctrine for the first time intuitively reject it (“you mean if one person gets it, it’s a subsidy, but if everyone gets it, it’s not a subsidy to the first person?”), as reflected in the US decision *Cabot Corp. v. U.S.* (9 C.I.T. 489, 620 F. Supp. 722 (1985)) but later modified in *PPG Industries, Inc. v. U.S.* (11 C.I.T. 344, 622 F. Supp. 258 (1987)).
- There is a significant big-country, small-country (or big-economy, small-economy) problem, as smaller economies will inevitably have fewer industries than big ones, and thus appear more specific. So far only one case has raised the issue of “diversification of the economy” from ASCM, Article 2.1(c), and unsuccessfully at that, although a recent Appellate Body decision suggests that more such cases are on the way. Perhaps one option is to place the burden on the decision-maker to prove the limits of the economic diversity on the basis of positive evidence.
- Many resource-depleting energy subsidies could well be non-specific (e.g. furnishing cheap fossil fuel to a wide variety of industries) but so could renewable energy.

However, if specificity were to be eliminated, some sort of substitute would probably be necessary. Possibilities could include:

- A better economic measure of the effect of the subsidy, to take into account the economic effect of very broadly used subsidies with floating exchange rates. Or comparison with subsidies to the complaining industry. But this would eliminate the “filter” effect necessary to prevent an unlimited number of cases of “normal” government functions being investigated.
- *A priori* exclusions of government functions, such as education, roads and so on, would not solve the problem as a “positive list” would be extremely long and difficult to negotiate, while a “negative list” protecting “normal government functions” would simply require case-by-case adjudication of the same sorts of issues.

# 4. Process: Monitoring and Next Steps

The procedures for establishing, monitoring and resolving disputes for the different types of subsidies categorized in section 3 would not necessarily be identical, although there would be certain commonalities.

## 4.1. Who Decides?

The issue of who decides can be fraught. The ASCM takes a mixed approach. The multilateral dispute resolution process provided for in the WTO reflects the goal of having a neutral decision-maker determine whether members' interests have been harmed through the use of subsidies. The ASCM also allows for national decision-makers in the form of countervailing duty actions. When such a unilateral approach is taken, however, there is an inherent tendency in the decision-maker towards a protectionist bent. Moreover, only large market economies can use countervailing duties effectively (Clarke 2015). Thus, we consider that a neutral decision-maker is preferable.

### 4.1.1. Neutral decision-maker

There will always be “boundary” issues to be adjudicated. For example, if subsidies that aim to support “green energy” are treated differently, someone will have to decide in specific disputes about whether the object fits within the definition in the text of “green energy.” As another example, if there is a specificity rule, someone will have to decide if the programme at issue is specific or not. The advantage of a neutral decision-maker is that one can apply a broader definition of subsidy (i.e. one that encompasses more subsidies) that would discipline more effectively, because a neutral decision-maker is less likely to apply such a definition in a protectionist way than would national authorities.<sup>21</sup> The WTO dispute settlement process is designed to establish neutral decision-makers for disputes, but the limited use of the process for subsidy complaints indicates that other options should be considered.

One possible neutral decision-maker would be the Permanent Group of Experts as established in ASCM, Article 24, or a similar multinational group of people with expertise. This has worked sufficiently well with the WTO Appellate Body and some of the PGE groups have been highly qualified. The following matters, however, would need to be addressed.

- Who could ask this new expert group (PGE) about a subsidy (WTO members, non-member governments, non-governmental organizations, individuals, direct competitors, upstream or downstream affected industries, etc.)?
- What remedies would the PGE have available (see section 4.3 below)?
- How could a set of procedures be set up to enable the processing of a large number of complaints (and very rapidly)?

Another option might be to use existing arbitration practices. Some disputes (possibly concerning prohibited subsidies) could be subject to binding arbitration. These arbitrations should be established on an expedited basis; perhaps with a 30-day consultation period between the disputing nations followed by a 90-day arbitration. Any damages found would be enforceable under the New York Convention on the Recognition of Foreign Arbitral Awards among signatories.

### 4.1.2. Unilateral decision-maker

The ASCM provides for unilateral subsidy discipline actions in the form of countervailing duties and outlines rules for how such actions are to be undertaken. Nevertheless, experience has proven that the rules allow sufficient leeway that decisions on the same subsidy will vary from country to country. As noted, the most important problem is that the administering authorities of such countervailing duties, even when they begin as neutral fact finders, tend to develop a protectionist bias over time.

These inherent problems argue for the elimination of a unilateral option. If, however, this proves to be politically untenable, the current system should (at a minimum) be re-examined and adjusted to apply to only the narrowest definition of subsidy and with tweaks to how the benefit is determined (perhaps as discussed in Box 1). Moreover, if unilateral measures are not eliminated, attention should be paid to establishing rules that would result in more neutral decision-making, such as offsetting only the effect of subsidies in excess of the subsidies received by competitors in the importing country. In addition, national decisions must be subject to a binding dispute resolution that is much faster than the current WTO system—beginning with initiation of a case when the commercial damage begins and restoring the status quo *ante* for the exporter (if it wins),<sup>22</sup> unlike the current system that does not even repay the illegally collected duties in CVD cases.

## 4.2. Questions of Proof

The existence of most subsidies is not a secret—the governments (and politicians) providing them typically want political credit for handing them out.<sup>23</sup> The main exception seems to be questions surrounding whether a government covertly “directed or entrusted” the subsidy. An example would be the *Korea-DRAMs* national CVD cases and then the Korean challenges to those countervailing duties at the WTO. A close reading of the decisions seems to indicate that the Appellate Body allowed importing countries to consider the alleged subsidy to have been directed by the Korean government even though there seems to be no direct evidence of that involvement—“they knew it when they saw it.” If the goal is discipline on subsidies, then one would want a similarly relaxed standard of proof in such cases; while if one fears protectionist use of countervailing duties, then one would wish for a more normal standard of evidence, or possibly even the “positive evidence” required (albeit frequently ignored) under ASCM, Article 2.4, for findings of specificity. This, in turn, underlines the need for neutral decision-makers, who may be better trusted with the looser standards.

The same issue occurs with the question of “public body” if the definition is stretched too far. A recent US Department of Commerce decision that a military pension fund is a public body because its board of directors includes a high proportion of government officials (the military officers, active or retired, whose pension funds are at stake, with no evidence of government direction) may reflect more a problem with the notion of public body (if the decision is eventually challenged, then a question of proof will arise).

A similar problem arises from the implicit “local content” requirements probably occurring with almost all subsidies, precisely because such local content requirements would create a prohibited subsidy under ASCM, Article 3.1(b). Sometimes the political bargaining requires that these be made explicit.<sup>24</sup> More typically, however, those requirements are implicit—companies receiving the money know that it would be politically unwise to spend substantial portions of it on imported inputs. Presumably this is more a problem for large economies than small ones (where the voting population is more likely to understand the need for imported inputs), but it is understandably a difficult topic to research. Perhaps the answer is that a neutral decision-maker be given a certain degree of latitude (as well as the power to obtain facts or use adverse inferences).

The more general problem is that all (or almost all) subsidies have implicit “strings attached,” which typically reduce the value of the subsidy. For example, although local content subsidies are prohibited by ASCM, Article 3, the economic reality is that the trade they distort is not always (or even mostly) in the product being subsidized, as the LCR raises the cost of producing that good and therefore decreases

competition with unsubsidized competitors to the extent that the value of the subsidy is less than the additional cost (perhaps at that point the subsidy would be refused). The US initially recognized that the net value of the subsidy could be less than the gross value, but subsequent, more protectionist authorities in the US and elsewhere ignore this fact. The ASCM recognizes it only to the extent of “application fees, etc.”—the cost of which is trivial compared with “strings” such as keeping a plant open, employing too many workers, and so on. Most often, the value of the subsidy exceeds the value of the “strings” (or else the subsidy would not be taken) but it can be considerably less than the gross value.<sup>25</sup> Of course, measuring the value of those strings should be subject to a very high standard of proof, since the information is often hidden and almost invariably in the hands of the recipient of the subsidy.

## 4.3. Remedies

The remedies currently available for questions of subsidies discipline depend very much on the venue. At one extreme, the EU system—including the Court of Justice of the European Union—in most cases seems to be able to require the repayment of the subsidy and make it stick. At the other end, there are agreements among sub-central entities in the US not to compete for locational subsidies, which, so far, have almost invariably dissolved in the event of the contest for new investment.

To date, the WTO system does not seem to have been able to ensure repayment of subsidies (*Australia-Leather*), and in at least one case the two parties formally agreed not to comply with the rulings (*Brazil/Canada-Aircraft*). In another case, one member paid a large monetary compensation (but considerably less than the amount of the subsidy) instead of complying (*US-Cotton*). At most, the current system seems to be able at times to stop the future or continued granting of subsidies, but clearly has not been able to deal with large “one-time” subsidies granted prior to a dispute. Moreover, the possibility in the WTO system to provide compensation instead of complying with an unfavourable decision confers an advantage to richer countries that are able to buy their way out of decisions that have unfavourable political consequences at home—an option not available to poorer countries.

## 4.4. Definitions of Subsidy

A wide range of subsidies are not subject to current disciplines almost by implication. These include:

- Most obviously, non-specific subsidies (discussed in section 4.4.2);
- Subsidies that do not cause adverse effects or serious injury are subject to minimal discipline under the ASCM (in the form of notification requirements) unless they fall into the “prohibited” category—a narrow category including only export-contingent subsidies and subsidies contingent on the use of local goods (but not services);

- Perhaps more seriously, subsidies that do not cause “trade injury” but which harm the global commons are not disciplined under current subsidy discipline systems (although there may be other constraints on their use such as environmental standards).

There are a number of other subsidies that are also excluded from discipline, including those that fall outside the ASCM definition of subsidy, which we now briefly discuss.

#### 4.4.1. Regulatory distortion

The most obvious exclusion from the ASCM is “regulatory distortion.” As conveyed in section 2 *supra*, this is probably a bridge too far to discipline comprehensively.

#### 4.4.2. Cross-border subsidies

To date, cross-border subsidies as such have not been subject to specific discipline. An example would be a subsidy to Company A that operates in Countries 1 and 2. If the subsidy has no conditions (i.e. it is not “tied” to Company A operations in Country 1), then the subsidy would be allocated over all the operations of Company A (probably by dividing the annual value of the subsidy in some currency unit by the net turnover of Company A in both countries) to yield a value which could be applied to the product exported from Country 1 (and a complaint is brought to the WTO or for a countervailing duty against exports by Company A from Country 1). This concept has been codified, with certain exceptions, in the US countervailing duty regulations in 19 CFR 351.527, which states that a subsidy does not exist if the funding was provided by a government of a country other than the country in which the recipient firm is located or by an international lending or development institution.

The vast expansion in cross-border production (involving global value chains) requires some thought as to whether the mechanical approach described above is the best. The underlying assumption is that Country 1 would never subsidize activity outside its own borders. Is that still the case? Assume instead that the subsidy is from Country 1, but the export is from Country 2. Assume further that the exported goods involve no input imported from Country 1. Would that justify a countervailing duty case or WTO case (brought by Country 3) against Country X? Assume further that Country 3 does not produce the product at issue, but is only the corporate headquarters for Company B, a competitor of Company A.

The current agreement does not prevent applying discipline to cross-border subsidies (except perhaps through the specificity definition in Article 2.1). The Airbus case before the WTO raised this issue implicitly as it considered subsidies from four countries within the EU, but the issue was not raised explicitly (i.e. the EU did not challenge the applicability of subsidy disciplines to the four countries on those grounds). Moreover, some countries’ countervailing duty practices allow duties in response to cross-border subsidies in certain instances (such as the US provisions for “international consortia”), but such cases are unusual.

Therefore, the growth of GVCs argues for a full analysis of the impact of such cross-border subsidies and consideration of how, or whether, they should be disciplined.

#### 4.4.3. General infrastructure

“General infrastructure” is excluded from the ASCM in Article 1.1(a)(1)(iii). The boundary issue inevitably arises. Can a road be a “specific” subsidy?<sup>26</sup> Are port facilities a specific subsidy?<sup>27</sup> The decision on specificity may also be a decision on benefit, with the measurement being the difference between the specific and the non-specific. The existence of boundary issues is not fatal: there is no mathematical formula for specificity (as with causation) but rather a need for neutral decision-making.

One could make the argument (similar to environmental subsidies) that general infrastructure subsidies have positive externalities and should be non-actionable. Another point, from the perspective of developing countries, might be that while developed countries have already built their infrastructure, they seek to discipline countries that are at an earlier stage of infrastructural development.

#### Box 2: Big and Rich vs. Small and Poor Country Issues

In general, wealthy countries can give more subsidies than poor nations. Some emerging countries, such as Brazil, China, and India, now have enough money at a national level to provide large subsidies. What is sometimes less appreciated is that only large markets have the ability to do much about other countries’ subsidies. While any WTO member can utilize the dispute settlement process against another members’ subsidies, in practice relatively few countries have done so and they tend to be the overwhelmingly large and relatively well off. Only Brazil, Canada, Korea, Japan, the EU and US have successfully litigated against other members’ subsidies.

More importantly, only large markets have the retaliatory capacity to force meaningful action after winning a WTO case against subsidies. As seen in the case of U.S.-Gambling (a non-subsidy case), even the threat of cross-sectional retaliation against intellectual property rights has been insufficient to move a large member such as the US, because the retaliation likely to be authorized will not be sufficiently large. This situation is even more pronounced with respect to countervailing duties. While a total of 21 countries have initiated countervailing duty investigations, in practice the calculation of a large WTO member (or recipient company of a large member) is to take the subsidy when the only threat is to pay back a tiny share in a countervailing duty imposed by a small member.

<sup>26</sup> Softwood Lumber from Canada, 70 Fed. Reg. 73,448 (Dec. 12, 2005).

<sup>27</sup> Groundfish from Canada, 51 Fed. Reg. 10,041 (Mar. 24, 1986); and AK Steel Corp. v. U.S., 192 F.3d 1367 (Fed. Cir. 1999).

Further, on the supply side, a small member is likely to have a narrower range of industries and is thus more likely to be found providing “specific” subsidies, notwithstanding the language in ASCM, Article 2.1(c), concerning “economic diversification.” The same is true for Footnote 3 in ASCM, Article 3, but in the other direction. In theory, Footnote 3 suggests that small countries can give subsidies that in effect are contingent on export; because the smaller the country the more likely it is that the vast bulk of production will be exported. Yet this presumed advantage has been wiped out by the broad reading of Footnote 3. For example, Canada in the Aircraft case<sup>28</sup> argued successfully that a subsidy to a product where over 90% of the production would be exported is protected by Footnote 3, which means that only very few countries are not thus protected.

#### 4.5. How to Get There

It may seem surprising to be thinking about changes in current subsidies disciplines given the general stagnation in WTO rules negotiations and the relative lack of interest in making major amendments to the ASCM in the ongoing Doha Round (except with respect to fishing subsidies). Nevertheless, the issue deserves renewed attention and effort.

Interpretation of the ASCM by the Appellate Body would appear unlikely to bring about major change, as the Appellate Body in the best of cases is (mostly) trapped by the existing text. What about renegotiating the text to focus on economies big enough and rich enough to give large subsidies that affect international trade significantly? A lot of time and energy in the Uruguay Round was spent worrying about how to limit subsidies by countries too small to have an impact.

Are there approaches outside the WTO that could work? At first sight, no other organization covering most countries seems likely to tackle the issue. But this is misleading—it is almost certain that changes will be made in subsidy disciplines in the course of high-level negotiations over climate change, and, perhaps, disappearing fish stocks. However, the likelihood of this being done in a way that fits smoothly within the WTO system is low, unless the WTO *ex-post facto* waives whatever inconsistencies occur.

Gregory Shaffer et al. (2015) offer some promising soft law alternatives. The OECD export credit arrangements have been reasonably successful at achieving recognition of the rules and reaching compliance, although the rules are not as hard as WTO rules. Greater transparency would help. However, even widely publicized lists of subsidies have at best a mixed record in obtaining reform.<sup>29</sup>

#### 4.6. Data Collection

Getting better data is a key next step for the subsidies discipline debate. At present, the data is sparse, ad hoc and unreliable. The formal intergovernmental notification process has not produced the necessary breadth or depth of information about subsidies. It is unlikely to achieve this end as the people responsible for undertaking the work do not have the time or resources (or the incentive) to produce a deep and consistent set of data that would permit better policy discussions and decisions. The work produced by the OECD is perhaps as good a multilateral government effort as is currently possible. “Reverse” notification (e.g. by competitors or public interest groups) may achieve better results but not in a systematic manner.

While the ASCM encompasses some of the subsidies within its transparency and reporting requirements, experience has found that WTO reporting vastly understates the full extent of subsidization.<sup>30</sup> Extending beyond government-based notifications may be necessary.

Additional information (such as that produced in the Global Subsidies Initiative study of Germany) could be obtained through a coalition of universities and independent think tanks around the world (or the Worldstat statistical agency as proposed by the Oxford Martin Commission for Future Generations in 2013). A loose university consortium, supported by funding, could include a variety of institutions using common standards and definitions with graduate students and researchers seeking out the data.

#### 4.7. Concluding Note

Reaching consensus on a comprehensive agenda of the type presented in this paper could firmly position the issue of international subsidies disciplines as an important vector for the improved coherence and effectiveness of the international trade system for sustainable development. This agenda includes revisiting disciplines under the ASCM by creating a category of non-actionable subsidies as well as a category of government support measures subject to absolute or presumed prohibition. It also calls for the formation of some discipline on services subsidies to be explored. In addition, the procedures for establishing, monitoring and resolving disputes should be recalibrated; with neutral decision-making strengthened and the option for unilateral action eliminated or restricted. Policy-makers interested in advancing reform are encouraged to consider these options for discussion and early implementation.

<sup>28</sup> Canada –Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/RW (Article 21.5) (21 July 2000) at paragraphs 48-51.

<sup>29</sup> Lists include the farm.ewg.org subsidy database in the US and farmsubsidies.org in the EU.

<sup>30</sup> For example, Germany notified 11 subsidies for 2006 to the WTO, worth a total value of €1.25 billion. Yet a case study carried out for the Global Subsidies Initiative of the International Institute for Sustainable Development (Thöne and Dobroshke 2008) identified some 180 specific subsidy programs, worth almost €11 billion, that should have been identified (and there is no reason to believe that Germany is an unusual case).

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Clarke, Peggy A. 2015. *Rethinking Countervailing Duties*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

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The papers commissioned for the E15 Task Force on Rethinking International Subsidies Disciplines can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Current Status	Gap	Steps	Parties involved
<b>Revisiting International Disciplines</b>				
1. Create a category of narrowly defined non-actionable subsidies with clear boundaries and covering the following types of subsidies				
Subsidies to address climate change and similar environmental issues	Subsidies are actionable. Relatively narrowly defined exceptions for environmental subsidies, envisioned under ASCM, Art. 8.2, expired after the 1999 Seattle Ministerial Conference.	Need to scale up deployment of clean energy, support efforts towards climate change adaptation and address negative environmental externalities.	Difficult “boundary issues” to be handled by a mix of “hard” and “soft” law (e.g. the originally envisioned Permanent Group of Experts in the ASCM)  Need to differentiate, for example, between subsidies promoting the use of clean energy from those targeting the manufacture of clean energy.	Policy-makers interested in advancing reform Relevant IGOs and stakeholders (e.g. WTO, UNEP, environmental NGOs, think tanks) Private sector leaders
Regional development subsidies offsetting the additional cost of investment in a particular region compared to the rest of the country	Subsidies are actionable. Relatively narrowly defined exceptions for regional development subsidies, envisioned under ASCM, Art. 8.2, expired after the 1999 Seattle Ministerial Conference.	Many countries, especially developing countries, experience extreme disparities in the cost of investment in different regions and high variations in income and employment opportunities in those same areas. Some financial redistribution may be logical, as well as politically inevitable.	To prevent abuse, such subsidies should be limited to offsetting the additional cost of investment in a region. Another option is to give preference to the poorest countries. Use the type of provisions found in ASCM, Art. 27, to define inclusion and graduation as opposed to self-selection.	Policy-makers interested in advancing reform Relevant IGOs and stakeholders (e.g. World Bank, development think tanks)
R&D subsidies for R&D which would not occur without support and the result of which is publicly available	Subsidies are actionable. Relatively narrowly defined exceptions for R&D subsidies, envisioned under ASCM, Art. 8.2, expired after 1999.	With some R&D, a company cannot expect to capture the full benefits. As a result, companies invest less in R&D than is desirable for society as a whole.	Since the public would be funding such R&D (through subsidies), the safe harbour could require that the results of the R&D be publicly available to any who seek to use it.	Policy-makers interested in advancing reform Relevant IGOs and stakeholders
Natural - or other - disaster recovery (time-limited and not exceeding pre-disaster state)	Subsidies are actionable. Currently no explicit carve out for natural or man-made disaster recovery envisaged under the ASCM.	In recent years, the world has experienced natural disasters of such magnitude that recovery from them requires extraordinary investment. A similar rationale applies to time-limited use of subsidies to allow an economy to recover after certain man-made disasters	Would need to be time restricted, with metrics established to determine when the recovery period has ended. The safe harbour would need to be very specific on the magnitude of the natural disaster that would qualify for such treatment.	Policy-makers interested in advancing reform Relevant IGOs and stakeholders (e.g. United Nations Office for Disaster Reduction)

Policy Option	Current Status	Gap	Steps	Parties involved
2. Expand the category of subsidies that could be subject to absolute prohibition or a presumption of prohibition (such as in the now-defunct ASCM, Article 6.1)				
Locational subsidies to attract investment (in goods and services)	Subsidies currently considered as actionable. Pervasive in the US, in particular at the state and local levels. The emergence of GVCs will exacerbate this trend worldwide. Sporadic attempts to discipline them have proven unsuccessful.	The competition to attract investment can lead to a race to the bottom. While politically difficult, there is a strong rationale for international cooperation to discipline such subsidies.	Focus on subsidies dependent on a specified/target company building a new or expanded facility; or subsidies dependent on a target company staying in an existing facility for a period of time (or indefinitely).  May be desirable to use a broader definition than the ASCM to include other government actions, such as regulatory waivers, that have a similar effect.	Policy-makers interested in advancing reform  Relevant IGOs and stakeholders (e.g. UNCTAD, civil society organizations)
Subsidies for the exploration, production or use of fossil fuels, taking into account the importance of consumption subsidies for poor people	Subsidies currently considered as actionable. Limited transparency and subsidy reporting. WTO reporting vastly understates the extent of the subsidization that occurs.	Encourage the depletion of a non-renewable natural resource and lead to greater emissions of greenhouse gases. Yet, under current rules, cannot be challenged based on the environmental externalities they generate.	First steps could include better notification and peer review (e.g. within the OECD or G20)  Pursue immediate stand-alone phase out of fossil fuel production subsidies, leading to an eventual ban on all fossil fuel subsidies.	Policy-makers interested in advancing reform (e.g. G20)  Relevant IGOs and stakeholders (e.g. OECD)  Private sector leaders
Other natural resource-depleting subsidies such as fisheries subsidies combining a prohibition of the most egregious ones (capital cost, variable costs, price support) and leaving others as actionable	Same as above	As above, typical illustration of the tragedy of the commons.  Need to define hard law prohibition of specific types of subsidies that are most likely to increase resource-depleting activities, combined with a recognition that most other subsidies would be actionable	Pursue multilateral, regional or plurilateral avenues, including through a mix of soft and hard law disciplines, to address specific concerns on subsidies (e.g. sectoral initiative on sustainable fisheries).	Policy-makers interested in advancing reform (e.g. G20, SDG)  Relevant IGOs and stakeholders (e.g. OECD, UNEP, FAO)

Policy Option	Current Status	Gap	Steps	Parties involved
<b>3. Establish disciplines on certain subsidies currently not covered by the ASCM</b>				
Establish some form of services subsidies discipline	GATS negotiations on the appropriateness of subsidy discipline have been unable to reach consensus on whether or what form subsidy discipline for services should take.  Significant lack of data and transparency on services subsidies.	As with trade in goods, services subsidies can generate trade distortions but may also be used to correct market imperfections and ensure the delivery of certain public goods	Start with collection of better data.  Definition of subsidy and potential remedy would have to be adjusted to account for the different nature of services trade and the different modes of delivery.	Policy-makers interested in advancing reform  Relevant IGOs and stakeholders (e.g. OECD, World Bank, GTA)
<b>Establishing, Monitoring, and Resolving Disputes</b>				
<b>4. Strengthen the role of a neutral decision-maker in the resolution of subsidies related disputes.</b>	ASCM takes a mixed approach involving both a neutral decision maker (e.g. WTO Panel) and national decision maker (e.g. countervailing duties)	When a unilateral approach is taken, there is an inherent tendency in the decision-maker towards a protectionist leaning. Moreover, only large market economies can use countervailing duties effectively.	Establish a multinational group of experts as neutral decision-makers (e.g. Permanent Group of Experts in ASCM, Art. 24)  Use expedited arbitration procedures with some disputes (perhaps concerning prohibited subsidies) subject to binding arbitration.  Re-examine the question of proof, benefit, remedies, specificity and the impact of cross-border subsidies in a world of global value chains.	Policy-makers interested in advancing reform  WTO members
<b>5. Eliminate the option for unilateral action (e.g. countervailing duties) or at least constrain and make it more restrictive.</b>	The ASCM provides for unilateral actions in the form of countervailing duties and provides rules for how such actions are to be undertaken.	Same as above	Redefine how the notion of benefit is determined  Limit countervailing duties to offsetting only the effect of subsidies in excess of the subsidies received by competitors in the importing country.	Policy-makers interested in advancing reform  WTO members

Policy Option	Current Status	Gap	Steps	Parties involved
<b>6. Generate better data on subsidies through a consortium of universities/ independent think tanks</b>	Data on subsidies and subsidy notification sparse, ad hoc, incomplete, and unreliable.	<p>The intergovernmental notification process has not produced the necessary breadth or depth of information about subsidies, and is unlikely to due to lack of resources and incentives.</p> <p>“Reverse” notification (e.g. by competitors or public interest groups) does better, but not in a systematic manner.</p>	Establish a loose university consortium including a variety of institutions around the world using common standards and definition with graduate students seeking out the data.	Consortium of universities and independent think tanks, supported by funding.

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The experts all participated in their personal capacity. The views and recommendations expressed in the policy options paper are not attributable to any institution with which members of the E15 Task Force are associated.



## International Centre for Trade and Sustainable Development

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Established in 1996, ICTSD's mission is to ensure that trade and investment policy and frameworks advance sustainable development in the global economy.



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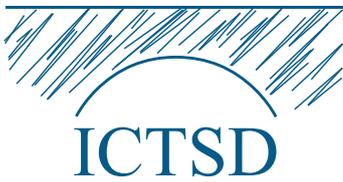
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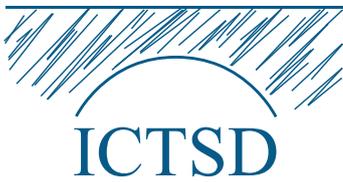
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