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**Trade Governance:**

Start at the Beginning

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## **Trade Governance.....Start at the Beginning**

### **Background**

The current international trading system has several parts, of which the WTO is the largest and most important. The WTO is unique in that it is a contract and decisions are made by consensus. The latter means that at a formal level, decision-making in the WTO has a democratic character. Yet many countries have expressed dissatisfaction with the non-participatory and insufficiently democratic nature of its processes. Changes to the dispute settlement system wrought by the Uruguay are seen by some as tilting the balance too far in the direction of legal interpretation of rules. The single undertaking concept is also perceived to have strengthened the reach and power of the WTO.

But governance of the world trading system has not been the exclusive preserve of the WTO<sup>1</sup>. Trade policies are being formulated and implemented in other fora. Already, the WTO faces challenges from unilateral, bilateral and regional trading arrangements raising fears that this might undermine the multilateral trading system centred on the WTO. The imposition by the US, of extra-territorial sanctions against companies doing business in Cuba is a good example of unilateralism in trade policy, while recent examples of bilateralism include free trade agreements between the US and countries like Australia, Jordan and Singapore. At the same time, preferential trading agreements between developed and developing countries are on the wane – a development that some see as strengthening the multilateral trading system, while others regard it as further marginalising the poorest developing countries.

The aim of this paper is to explore the arguments for enhanced international trade governance and situate them in the context of the domestic policy making process in developing countries. In doing so, it argues the case for giving priority to strengthening the domestic policy making process. It also assesses the extent to which developing countries' ability to make policy has been constrained by international trade rules and regulations.

### **Globalisation and the Policy Making Process in Developing Countries**

The debate concerning governance of world trade is of course, not new. Much of that debate has focused on the political and economic impact of globalisation. One obvious effect of globalisation on developing countries has been to

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<sup>1</sup> Governance is defined as the over-arching system of rules and standards designed to manage the world trading system.

complicate policy making in developing countries, particularly given that these countries lack the financial and human resource capacity to formulate and implement policy. Coordination of interlinked policies presents major challenges as does the need to ensure coherence between different strands of government policy and the rules and regulations set by international organisations to which developing countries belong. Policy-makers also worry that they are losing control over large areas of domestic policy, which are now subject to international rules and regulations.

The concerns of developing countries stem from the following:

- Growing inequalities within and between countries. Globalisation has brought benefits to some while placing others at a disadvantage. Within countries, individuals and groups linked to the international economy are likely to have done well even if they are citizens of poor countries. On the other hand, countries with few linkages to the international economy are increasingly being marginalised.
- Globalisation has unleashed political struggles in developed countries over issues like sovereignty, cultural traditions, environmental protection and worker rights, largely reflecting fears about job losses, poor environmental standards and cultural homogenisation.
- The temptation to use trade policy to achieve geopolitical ends has grown. This is most evident in the growth and content of unilateral, bilateral and regional trading agreements. In the particular case of the US, free trade agreements (FTAs) have sometimes been used to favour friends – for example Australia has been favoured with an FTA while New Zealand has been denied one. These agreements have also been used as testing ground for accords on new issues that developing countries have resisted at the multilateral level - recent examples of this being the incorporation of labour and environmental standards in the US/Jordan FTA and treatment of capital controls in the US/Singapore and US/Chile FTAs.
- The integration of disparate activities, made possible by new technologies in communications and information has complicated trade negotiations, with the result that the WTO already deals with many sensitive domestic policy issues
- The emergence of new participants in international trade negotiations: Whereas previously only a small group of large developing countries actively participated in the WTO, a large number of developing countries are now involved. (check Wilkenson)
- Internationalisation of production: the new pattern of economic growth and competition has increased pressure on many firms and companies to internationalise their production, leading to an increase in foreign direct investment (fdi) to a few developing countries. This has provoked

complaints of poor labour and environmental standards in developing countries.

Overall then, globalisation has brought new participants on the scene, new kinds of trans-national exchanges and new relationships into the international trading system. This has spawned a policy agenda that is long, expensive and interdependent. It is therefore important to understand how the policy making process in developing countries works. Without this the debate on trade governance lacks context. It is also important to understand that the way developing countries' governments have formulated and implemented their trade policies since the 1980's has been heavily influenced by the international trade agenda. As has already been indicated, this agenda extends beyond what is done at the WTO, to unilateral, bilateral and regional trading arrangements.

The skills that a trade official from a developing country, (that is a member of the WTO and several other organisations) is expected to have are shown in the chart below. These could be summarised in the following way: (a) *analytical skills* to assess the implications of trade liberalisation undertaken under various agreements; (b) *coordination skills*, to coordinate their inputs of different stakeholders and their participation in trade negotiations; (c) *legal skills* to evaluate and implement new trade rules and modifications to existing ones; and (d) *networking skills*, to develop and maintain contacts with relevant private, public, academic and external trade organisations. These are in fact the essential ingredients of a coherent trade policy.

In part, this is because at GATT's inception, the concept of developing countries was not well defined. Almost all developing countries' trade policies were part of the metropolitan power's trade policies. This is clearly one of the reasons why areas in which developing countries have some comparative advantage, notably agriculture and textiles, were until the Uruguay Round, excluded from the disciplines of the GATT. In addition, interest in GATT/WTO membership increased after the conclusion of the Uruguay Round.

If one is among the weakest members of a club, they would naturally be interested in finding ways to increase their influence in regard to how the rules of the club are established and implemented. A weak member is also likely to be interested in the agenda-setting process, particularly the determination of the scope of the agenda, and the way disputes are resolved. Their interest is likely to increase during a period of major changes and uncertainty. In short, these are the concerns of developing countries and the reason for their growing interest in the governance of world trade. While the concerns raised by developing countries

appear largely procedural, the way the WTO agenda has been expanded in the past has raised fundamental questions of substance. The influence of rich and poor countries is of course, not symmetric.

In developing countries, globalisation has provoked fears of marginalisation and created policy dilemmas for governments. Crucially, it has made the task of making policy difficult and more complicated, largely because these countries do not have the infrastructure and human resource capacity to be able to formulate appropriate policies and implement them effectively. Policies typically range over a large number of interlinked issues, putting heavy demands on the country's capacity to coordinate their implementation. It is this context that enhancing the governance of world trade should be considered. If developing countries are giving up autonomy in certain areas of policy, the question that arises is: can the WTO be nudged in a direction would deal more effectively with issues of marginalisation confronted by them. But this might not be the most pressing issue to deal with because there are those who believe that the WTO still gives developing considerable room to implement independent policies.<sup>2</sup>

Beyond the WTO, a lot of developing countries are still uncertain as to the value of certain regional and hemispheric arrangements, particularly those involving developed and developing countries. For most of them, the costs of exclusion or non-participation seem to outweigh the costs that might arise from having to implement agreements that include issues on which they would rather have policy autonomy. This means they have to weigh the relative benefits of pursuing trade liberalisation at the multilateral level as distinct from bilateral and regional trading arrangements. For a lot of them this choice is not even available, either because they have little, in economic terms, to offer developed countries or they are of no consequence in geopolitical terms. The fragmentation of the international trading system also ties up scarce human and financial resources in multiple negotiations. Furthermore, if the practice of incorporating contentious issues into bilateral FTAs opens the way for these issues to be introduced at the multilateral level, developing countries that maintain their opposition might find themselves subject to trade sanctions on issues in which their trade interests are limited.

Improvements in the WTO's dispute settlement mechanism have increased the profile of the organisation. In particular, the fact that it has power to legitimate the right of countries to impose trade sanctions when their interests have been harmed, is seen as one reason behind the expansion of organisation's negotiating agenda.

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<sup>2</sup> Alice Amsden UNCTAD X (1999).

In developed countries, this has provoked political struggles over issues like sovereignty, cultural traditions, environmental protection and worker rights. These struggles have influenced developed countries at two levels: on the economic front, they have been keen to ensure that trade agreements they enter into do not worsen the economic position of workers and businesses, making it more likely that they will adopt protectionist measures to shield the affected workers and businesses from unfair foreign competition.

On the political front, pressure has grown to use trade policy to advance geopolitical interests. Part of the reason for the growing importance of bilateral trade agreements in America's trade policy is that it is also a way of favouring loyal friends. Thus, Australia has been 'favoured' with a trade agreement while New Zealand has been denied one.<sup>3</sup> More worryingly, these bilateral and regional trade agreements are also being used to establish "templates" for multilateral accords covering contentious issues. Many commentators have pointed to the incorporation of labour and environmental standards in the US/Jordan FTA and the way capital controls are treated in the US/Chile and US/Singapore FTAs as examples of this practice.

These developments affect developing countries in several ways. The focus on "competitive liberalisation" means that national trade policy is heavily influenced by special interest groups. The incorporation of contentious issues into FTAs, especially those between developed and developing countries, also tends to undermine the solidarity of these countries in their opposition to the expansion of the multilateral trade agenda. Additionally, the type of agreements reached at the regional level may be used as templates of agreements on the same issue at the multilateral.

### **Governance in the WTO**

Clearly some of the processes and approaches used in the WTO could be improved. Over the last few years, WTO members have attempted to do that, but as the preparatory process for the Doha Round showed, a great deal remains to be done. A key problem for the WTO is that it lacks an intelligent agenda-setting mechanism. How for example should WTO members decide on issues that should migrate on to the WTO agenda and those that should be kept at arm's length? Also what action is required if previous negotiations result in lop-sided agreements in terms of benefits and costs that they impose on different groups of countries? While there are no clear-cut answers to these questions, a useful principle to follow is that of mutual gain<sup>4</sup>. According to Bhagwati, governance could also be improved by providing short-term adjustment assistance and long-

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<sup>3</sup> Bhagwati & Baldwin Financial Times

<sup>4</sup> Bhagwati in Porter et al

term concessionary loans to countries adversely affected by the outcome of a major round of negotiations (such as the Uruguay Round). He also suggests that if a dispute settlement ruling implies a major adverse effect on developing countries, as in the banana case, then assistance should be provided to cushion the impact.

A second problem is that the two-year cycle of WTO meetings may have one major drawback, based on the experience from the four Ministerial meetings since 1995. While a key function of the WTO is that it acts to as a forum for trade negotiations, its members might want to reflect on whether positive outcomes are more likely if some ministerial meetings are used as to deal with built-up tensions in the system, without necessarily launching into new areas of negotiations or a new round of negotiations. It may well be that the endless rounds of trade negotiations that characterised the GATT may no longer be appropriate, given what is expected of member countries and the areas of negotiations into which the organisation is moving. The demands that these developments place on governments are simply beyond the capacity of many of them.

The third problem is related to the expanding WTO agenda. It could be argued that the WTO system is undergoing a paradigm shift as is evident from the fact that the organisation's programme of work on market access – traditionally its core competence – is in relative decline, while activities on positive rule-making in new areas such as services, intellectual property rights and investment are increasing. If this shift is to be managed properly, it ought to be recognised that a "pure" WTO in the sense of one devoted to trade issues only is unlikely to emerge as one that becomes a receptacle for every issue that comes along.

### **Have Developing Countries Got the Balance Right?**