

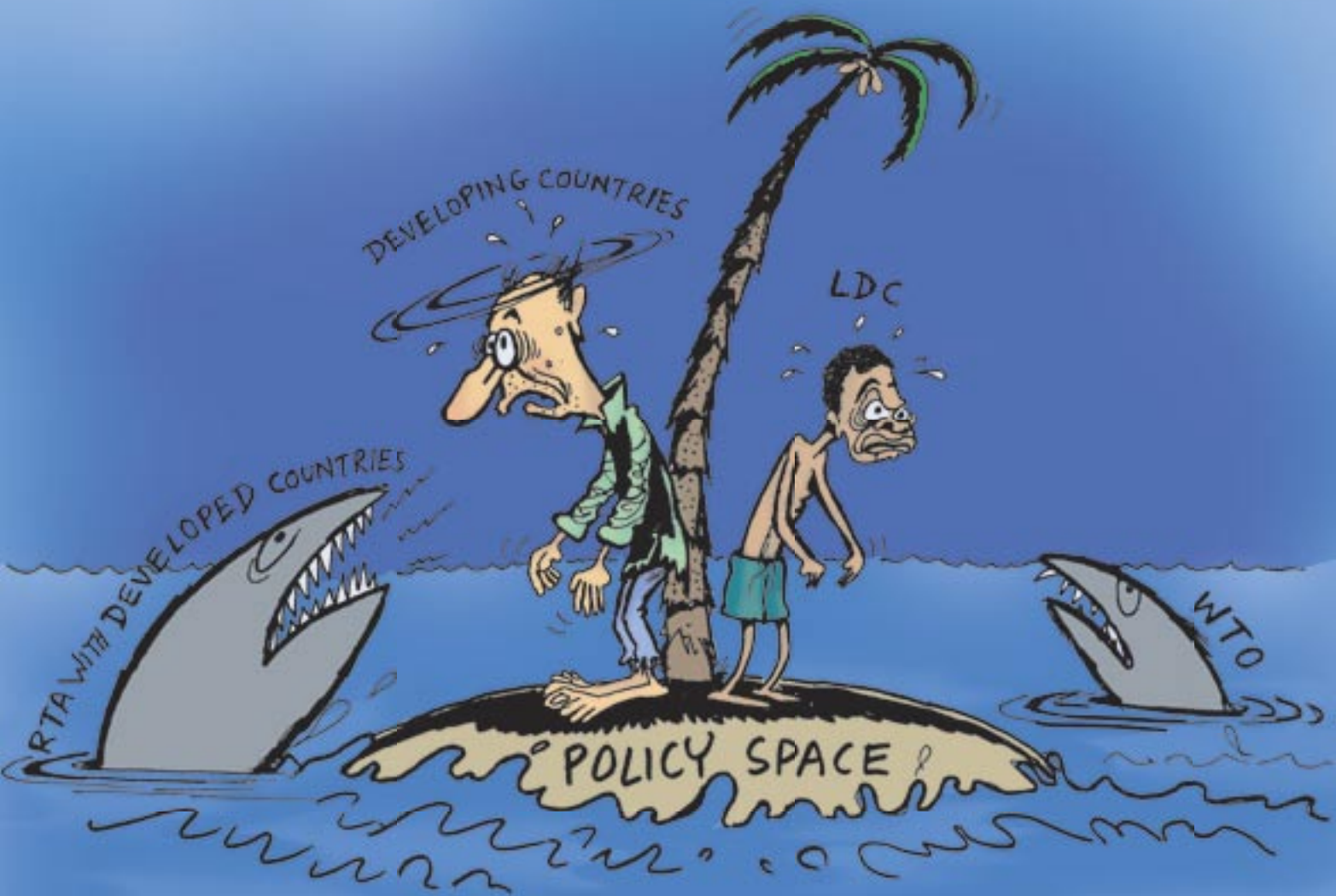


# TRADING



**Centad**  
Centre for Trade & Development

## Regional Trading Agreements in the Global Trading System



Caught Between the Devil and the Deep Sea?



Editorial

## Preferring Development over Preferential Trade



Lifting the Veil

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Stumbling Trade**

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# Preferring Development over Preferential Trade

The current issue of *Trading Up* comes at a crucial juncture when the WTO negotiations have been suspended indefinitely, owing to the intransigent stance of the developed countries at the conclusive stage of the Doha negotiations. Though efforts are still on to revive the negotiations, the shadow of US Congressional elections due in November 2006 and the impending expiry of the US FastTrack Authority in mid 2007 lurks large on the horizon. Development has yet again taken a back seat.

While the lack of urgency in bringing the Doha Round to a meaningful conclusion can be attributed to several factors, the emergence of Regional Trading Agreements (RTAs) as a preferred and feasible route to push an aggressive trade liberalisation agenda bypassing the WTO has been oft cited as an explanation to the continued stalemate. It has been suggested that as a second best option, the RTAs provide an alternative route to ensuring greater market access in key economies. It is no wonder therefore that the graph of the total number of RTAs is now set to rise further. Trade ministers/leaders of several Member countries, including India, have gone on record to declare their renewed emphasis on the regional route to trade liberalisation.

In addition, RTAs are also attractive since they offer a possibility of incorporating commitments far in excess of those found or being negotiated under the WTO Agreements. This is especially true of the North-South RTAs. A cursory glance at the salient provisions of the North-South RTAs reveals that more often than not they include provisions far stricter than those mandated by the WTO. These include labour clauses, investment rules, TRIPS-plus provisions as well as stricter arbitration clauses.

Notably, the South Asian countries thus far have not engaged in any RTAs with developed countries. On the positive side, the South Asian countries have not yet been coerced into signing on to onerous WTO plus commitments. However, a perception has developed that with countries in the ASEAN block along with other developing regions increasingly engaging with developed countries on RTAs, South Asia may face isolation in terms of its defensive positions in the WTO and being left out of preferential treatment ambit in developed country markets. In South Asia, though SAFTA heralded a promise of integration of the South Asian economies, it has still to realise its potential due to various economic and political bottlenecks. The South Asian countries, however, are continuing to engage in a number of RTAs with different countries across the globe leading to an exceedingly complex web of regional agreements with well known difficulties in terms of application of rules of origin to different products.

Viewed in this light, RTAs are being perceived more as stumbling blocks rather than as building blocks to the multilateral trade negotiations under the aegis of the WTO. It has been argued that they reduce the pace of negotiations at the WTO, divert valuable and limited negotiating capacity and provide incentives for keeping away from engaging constructively in a rule based multilateral trading system. Also, they have been seen as power-driven negotiations where developed countries like the US and the EU ensure outcomes favouring their aggressive business interests thereby pushing the agenda of development itself from the centre to the periphery.

Since the phenomena of RTAs looks well set to stay on, *Trading Up* in its current edition is attempting to bring the spotlight on the RTAs. Given the current stalemate at the WTO and the resultant renewed emphasis on RTAs, this is timely indeed. Hence, I believe, the readers will find the debates contextual and interesting. As always, feedback would be greatly appreciated.

■ Dr. Samar Verma  
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Oxfam GB

## Regional Trade Agreements – Stumbling Trade

Prabhash Ranjan

The multilateral trading regime that came into existence in 1947 in the form of General Agreement on Tariffs and Trade (GATT) and which was further augmented in 1995 by the formation of the World Trade Organisation (WTO) adopted the Most Favoured Nation (MFN) principle as the cornerstone of international trade. The MFN principle, according to which no country can discriminate between any two countries in matters of international trade, established the principle of non-discrimination in international trade. The MFN rule meant that whether a country is small or big, weak or powerful, poor or rich, its products would face the same barriers that the products of any other country would face while entering a particular export market. The MFN rule also lays down the framework for a rule based multilateral trading regime.

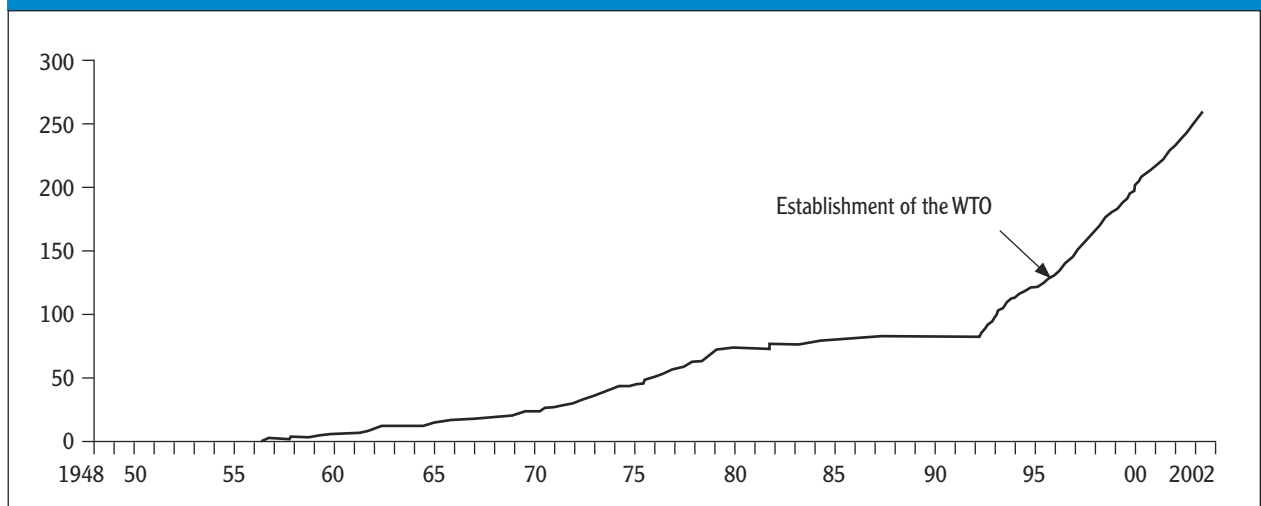
Any deviation from this non-discriminatory principle is considered to be an exception. Deviation from this rule takes place when two or more countries offer preferential treatment (such as low tariff rates) to each other's products. This movement away from the MFN rule is recognised in GATT/WTO as the formation of Regional Trading Agreements (RTAs) or Preferential Trading Agreements (PTAs). Notwithstanding the MFN clause, the General Agreement

on Tariffs and Trade (GATT) provides for certain exceptions allowing for such discriminatory trade policies. However, after 60 years of operation of GATT and more than 10 years of existence of the WTO, the exception is fast becoming the rule of international trade. Today, more and more countries are deviating from the MFN principle and entering into RTAs/PTAs. Interestingly this trend has demonstrated exponential growth after the formation of the WTO in 1995 (See Figure 1). From 1995 to 2002 the number of RTAs/PTAs has increased from being less than 150 to more than 250. In fact, today, the quantum of global trade conducted through RTAs/PTAs is more than 50 percent. This poses many questions such as why regional trading agreements are becoming such a strong shipper of international trade, why the Most Favoured Nation (MFN) basis or the non-discriminatory basis of conducting international trade is becoming unfashionable, what impact all this will have on the multilateral trading regime and the sluggish Doha round negotiations.

Before one tries to address these core questions, it is pertinent to understand why a multilateral treaty like GATT created an exception like this for RTAs. The intention of the GATT treaty makers was to use regionalism as a

Fig. 1

Increasing number of RTAs



Source: WTO, 'Regional Trade Agreements: Facts and Figures', [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm) (visited 22 June 2006)





North-South RTAs

tool to foster multilateralism. It was expected that the quickened pace of liberalisation at the regional level by lowering of tariffs would prepare countries faster for further liberalisation at the multilateral level and hence the barriers to international trade would rapidly come down. In other words the regional blocks were expected to act as building blocks to a more open and liberalised multilateral trading regime. It was also expected that regionalism would help smaller countries to forge customs unions and become sizable players in the multilateral trading regime thus overcoming their disadvantage of being small in size. Notably, many economists have put forward the theory of trade creation to support the formation of regional blocks. According to this theory the creation of a RTA/PTA shifts the demand from products originating in countries that are not members of the RTA to the products that originate from member countries because of their low price as they attract lesser duty. This demand stimulation boosts production and infuses intra RTA trade and hence creates trade.

However, the evolution of RTAs/PTAs over the last decade or so has revealed that the present RTAs/PTAs are anything but building blocks to multilateral trading regime. The most cardinal characteristic revealed by the present regional trade agreements is that it is a fallacy to call them regional. Today's

RTAs are not between countries of the same region but span continents and oceans. A case in point is the agreement between the US and Singapore or US and Australia. Today's RTAs have also broken the other infallible characteristic of such agreements being tariff-centric. Tariff is hardly the pivotal issue in the RTAs of today. In fact, they go far beyond tariffs especially the RTAs that involve both developed and developing countries cover a host of other issues that are not covered even by the WTO at present (such as competition rules, investment rules, etc.). Such RTAs are often found to include obligations far stricter than what is required by the WTO (e.g. stricter intellectual property provisions than what is required by the TRIPS Agreement of the WTO). Hence, instead of boosting multilateral trading regime, the RTAs today are endeavouring to create a parallel trading regime by becoming all encompassing, self-contained regimes.

### Increasing Number of RTAs

This brings us to the question – why has there been a sudden spurt in the formation of the RTAs/PTAs and why are so many countries especially developing countries deviating from the MFN rule. One reason for this is the sluggish pace of the Doha round of negotiations. At the start of this round in 2001, developing countries expected that successful completion of this round would usher in a regime of international trade

with fairer rules that would allow these countries to achieve the much cherished market access. However, the delay in the completion of this round and the direction of the negotiations has made many developing countries apprehensive about the commitment of developed countries to lower their trade barriers. Hence, unwilling to wait any more for the Doha round to get over, many of them have embarked on separate negotiations with different developed countries for preferential arrangements to quickly capture the elusive market access.

However, this elusive market access comes at the colossal price of compromising policy space. By getting into RTAs/PTAs many developing countries are now agreeing to all those demands of developed countries that they had successfully resisted earlier at the multilateral level. These demands often require developing countries to enact 'WTO plus' conditions or rules that would impose stricter obligations on them than what the WTO presently imposes. These WTO plus provisions could take different forms such as (i) rules on competition and investment (e.g. providing National Treatment to foreign investors, creating investor-state dispute settlement mechanism), (ii) stricter IPR regime (e.g. diluting the use of compulsory licensing, making it mandatory to give primacy to breeder rights over farmer's rights, increasing the term of patent protection from 20 to 50 years), (iii) bringing labour and environmental standards in the international trading regime, etc (See Table 1). Bringing these rules at the multilateral level in the WTO would mean compromising with whatever policy options the developing countries are left with after entering the WTO. Developing countries have been successful in resisting these demands in the WTO. However, in the bilateral or regional agreements they seem to be accepting all these demands. In fact, the real motive behind developed countries signing so many bilateral and regional agreements with developing countries is to get what they could not get at the multilateral level. For instance, at the time of the Cancun ministerial conference of the WTO, developed countries pushed very hard to include competition,

investment, trade facilitation and government procurement in the negotiating agenda. However, they failed and hence are now using the vector of bilateral and regional agreements to make developing countries comply with these rules. Thus, what were supposed to be tariff preferential arrangements for boosting trade have now become vehicles for developed countries to link trade with non-trade issues.

Increasingly, RTAs are also coming into existence, as an instrument to further political and cultural agenda. The formation of the Asean Free Trade Area (AFTA) is certainly one such example. Similarly, many have argued that India's economic and trade engagements with South East Asia, be it the comprehensive economic agreement with Singapore or the free trade area with Thailand, are a part of the larger political 'look east' policy of New Delhi.

### What is the Economic Desirability of RTAs?

Whether regional trading agreements are economically desirable or not is a difficult question to answer? The economists are divided right in the middle on this issue. While on the one hand the theory of trade creation is advanced to justify the formation of RTAs, on the other the theory of trade diversion is put forward to show the pitfalls of such regional arrangements. According to the theory of trade diversion, the countries that do not participate in the RTAs are at the receiving end. When a RTA comes into existence, the demand from efficient producers shifts to the inefficient producers who are members in the RTA because of lower tariffs. Hence, trade is diverted from the efficient producer to the inefficient producer. There is no conclusive proof to show whether in the case of RTAs trade diversion engulfs trade creation or gets engulfed. However, the past performance has shown that the economic desirability and efficacy of a RTA may vary from one case to another. It has often been observed that RTAs between developing countries or RTAs amongst the countries of the same region have yielded economic benefits to the constituent members. A case in point

**Table 1 WTO Plus Provisions**

	Investment Rules	Competition Policy	Labour Policy	Environment Rules
NAFTA	Y	Y	Y	Y
FTAA	Y	Y	Y	Y
CAFTA	Y	Y	Y	Y
US-Chile	Y	Y	Y	Y

Note: Y – indicates that this particular rule exists in the particular RTA.



WTO Plus Provisions in RTAs

is the AFTA. AFTA has been an accomplishment in spite of initial apprehensions regarding its success due to existing low volume of trade and lack of trade complementarities. Similarly, the bilateral trade agreement between India and Sri Lanka has been successful leading to increase in bilateral trade between the two countries.

Another major RTA that merits attention is the North American Free Trade Agreement (NAFTA). Some have hailed NAFTA as a success where as some describe it as a failure for Mexico. On the one hand there are statistics to demonstrate that from 1992 to 1996, the share of Mexico's merchandise trade with the US increased from 75 to 80 percent, while on the other hand there exist statistics to show that ten years of operation of NAFTA has meant a 300 percent import surge in corn and 500 percent in soybeans, wheat, poultry and beef in Mexico. Such massive import surges have led to 1.7 million job losses in the Mexican countryside. In fact, the WTO itself remarked about NAFTA in 1997 that Mexico's trade was too biased towards NAFTA. The complex rules of origin had diverted trade from the more efficient suppliers to US and Canada. The other significant fallout of the formation of RTAs

that has been relentlessly attacked by many economists is the complexity that RTAs add to the rules of origin. Different RTAs have different rules of origin and if one country is a member of more than one RTA, then it has to modify its products according to the different rules of origin of different RTAs. This acts as an impediment to trade liberalisation, rather than boosting it.

Therefore, there is no consensus amongst economists on how beneficial or detrimental regional trading agreements are. The truth of the matter is that it depends upon and varies from one RTA to another. Broadly, it has been observed that RTAs between developing countries have led to trade creation by promoting south-south trade.

### How Significant are the Legal Dimensions of RTAs?

The legal dimension of RTAs are very significant. The RTAs that come into existence as an exception to the MFN rule given in GATT/WTO have to comply with certain conditions. These conditions are:

1. The RTA should cover 'substantially all trade' between

its member countries. In other words, members of a RTA cannot deviate from their MFN obligation only for selected goods or commodities.

2. The formation of the RTA should not make trade more restrictive for non-member countries. In other words, the RTA should not impose higher trade barriers on non-members that are more than what existed before the RTA came into existence. This issue becomes even more important in the case of formation of a Custom Union because once a custom union is formed the individual tariff rates of its member countries are harmonised and converted into single tariff rates. In the case of formation of a Free Trade Areas (FTAs) this may not be an issue because members retain their individual tariff rates vis-à-vis non-member countries. There is no harmonisation of the tariff rates in FTAs.
3. The RTA should be notified in the WTO.

In understanding the legal dimensions of the RTA the biggest challenge is what does the coverage of 'Substantially all trade' mean. What proportion of trade between two countries can be treated as substantive or when can trade coverage be called substantive? There are no easy answers to this question, as even the GATT/WTO agreements do not provide any guidance in this regard. Similarly, there is another phrase 'other restrictive regulations of commerce' in Article XXIV of GATT that governs the formation of RTAs whose meaning is not clear.

## State of Play

Given this confusion regarding some of the concepts in Article XXIV of GATT, member countries of the WTO have often expressed concerns. This concern was taken on board during the Doha round of negotiations. In the Doha work programme,

countries agreed to negotiate to make the rules regarding the formation and functioning of the RTAs more simple. As these negotiations started in the Rules committee of the WTO, clear divergences started to emerge. On the one hand were countries that were actively involved in the regional agreements RTAs and hence wanted to have loose rules for RTAs in the WTO. On the other hand were countries that rely a lot on the multilateral trading regime for their international trade and hence wanted a stronger regime on RTAs. This tussle still continues as the Doha round is far from over. In the negotiations so far, countries have raised many important issues such as complex rules of origin due to the existence of so many RTAs, impact of the RTA on third parties or non-participating countries, limited welfare gains from RTAs due to key sectors being left out, lack of transparency etc. Notably, one significant development has taken place on the issue of transparency (See Box 1).

On the crucial issue of the meaning of 'substantially all trade', however, there still remains wide ambiguity. Countries such as the EU, China and Australia seem to be favouring a quantitative approach whereby 70 percent of the highly traded products should enter a RTA. In other words, according to this proposal if less than 70 percent of trade between two countries is liberalised through the formation of preferential trading agreement, then such an agreement will not be a RTA as per Article XXIV of GATT. Another important issue that has been raised by the African, Caribbean and Pacific (ACP) countries relates to special and differential treatment (S&DT) in the RTAs. These countries have made a proposal to explicitly incorporate S&DT rules in the RTAs.

However, it is important to note that the landscape of debate on RTAs within the WTO is undergoing a change as many of the

*(Contd. on page 26)*

### Box 1 New WTO Transparency Mechanism for RTAs

In June 2006 the Negotiating group on Rules has arrived at a decision regarding the new transparency mechanisms for all RTAs. The new transparency mechanism provides for early announcement of any RTA and notification to the WTO. Members will consider the notified RTAs on the basis of a factual presentation by the WTO Secretariat. The Committee on Regional Trade Agreements will conduct the review of RTAs falling under Article XXIV of General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS).

The Committee on Trade and Development will conduct the review of RTAs falling under the Enabling Clause (trade arrangements between developing countries). The transparency mechanism is to be implemented on a provisional basis. Members are to review, and if necessary modify, the decision, and replace it by a permanent mechanism adopted as part of the overall results of the Doha Round.

Source: Negotiating Group on Rules in the WTO, JOB (06)/59/Rev.5, 29 June 2006



# North-South RTA's Reinforce Existing Inequalities



*Jayati Ghosh, a renowned development economist, shares with Centad the development concerns relating to RTAs*

**Centad:** What, in your view, could best explain the reasons of a rather dramatic increase in the number of Regional Trading Agreements (RTAs) across the world, especially in the last decade and a half? Does the fact that RTAs can have World Trade Organisation (WTO) plus provisions turn them into a preferred negotiating option for developed countries?

**Jayati Ghosh:** WTO negotiations are becoming more difficult for the main developed country players to control in the same manner as before. Regional and bilateral deals have become the preferred framework for determining patterns of cross-border trade and investment and for enforcing liberalisation and opening markets in developing countries for multinational capitals, based in the industrialized nations. RTAs have proliferated at an unprecedented rate compared to previous decades. By the end of 2003, nearly 290 RTAs had been notified to GATT, and subsequently, to the WTO. Of these, more than 190 are estimated to be in force and another 60 or so are estimated to be operational but not yet notified.

RTAs have increased dramatically, despite multilateralism, on account of three broad reasons. Firstly, RTAs have served to fulfil some aggressively unilateralist attempts by the US (and later the EU) to forge specific relations with other partners independent of what has been happening on the WTO front. Another factor has been the relative failure of recent WTO rounds, which also serves to explain the sharp increase of RTAs post-Seattle and later after Cancun. From the point of view of the developed countries, it is clear that interventions at the multilateral level are now being combined and buttressed with bilateral and regional trading agreements to ensure control and access to markets across the world. Finally, RTAs have grown in part due to the desire of developing countries for greater market access, either in developed countries or with each other. As such, a shift has both negative and positive implications for the potential for autonomous trade and industrialisation strategies of developing countries.

**Centad:** In your assessment, would international trade of the future be increasingly conducted through the RTAs? What do you think are the developmental implications in such a scenario?

**Jayati Ghosh:** International trade is already conducted through RTAs (as per the WTO's own assessment, 70 percent of trade is conducted through RTAs). It is not correct to have one position on RTAs, the exact implications depend upon the specific bloc and the nature of the trade preferences provided. However, one needs to keep in mind that there is a world of difference between RTAs (especially in bilateral agreements). These agreements are initiated and pushed through by the governments of major developed countries under the influence of large capital and aimed at forging trading communities among developing countries to resist the hegemony of large powers in world trade. While the recent regional and bilateral deals involving major developed countries along with weaker developing countries have been unequal and have involved even more extensive opening of markets than is required by the WTO, the uncertainties created by the greater reliance upon such arrangements creates some space for engaging in more South-South deals across developing countries. This may have the potential over time to reduce the domination of large capital from the major developed economies in global trade and investment.

**Centad:** How should one view the RTAs: as building blocks to the multilateral trading regime or as stumbling blocks? Is it possible to have an overall assessment of the RTAs as welfare enhancing or welfare reducing from the point of view of the developing countries?

**Jayati Ghosh:** The standard economic theory which looked at the benefits of RTAs through either trade creation (seen as good) or trade diversion (seen as bad), assumes full employment and no scale economies and therefore is not really relevant to most countries today. In fact, if trade creation provides cheaper goods for consumers but also destroys employment and livelihoods for large parts of the population (as happened with the peasantry and small producers in Mexico), then it is not good. Conversely, if trade diversion preserves some employment in a country in a period of recession or falling employment in other activities (as happened in some Latin American Southern Cone Common

Market (MERCOSUR) countries), then it is good. So we should not have a doctrinaire approach, but assess each RTA separately in terms of its own conditions and implications. It is true that when RTAs are between very unequal partners (usually because the weaker partner desires more market access in the economy of the bigger partner) then it may reinforce existing inequalities.

**Centad:** How do you think countries like India should strategise while deciding for or against RTAs in the light of the current impasse in the multilateral process at the WTO?

**Jayati Ghosh:** Today most RTAs by developing countries are determined by the desire to get more market access, which in turn is driven by the obsession with export growth as the main instrument for economic expansion. This leads developing countries to accept all sorts of very damaging conditions, in terms of foreign investment protection, intellectual property rights and opening up of their own markets, simply to avail of what may be transient or minor gains in terms of market access. Sometimes, it is simply the fear of losing existing markets to rivals that leads countries to engage in potentially problematic Free Trade Agreements. Such agreements can then become a means of leverage in the WTO as well, allowing the large players to get more developing countries to accept multilaterally what they have already acceded to on a bilateral or regional basis.

**Centad:** What should be the key elements of a cost-benefit analysis for developing countries like India while engaging with RTAs?

**Jayati Ghosh:** The basic concern for India at present should be the likely impact of RTAs on livelihood and employment. Thus, the impact upon agriculturalists, small scale producers and workers should be the primary concern. All market access considerations should be judged in that light. Also, India should focus its attention in the manner in which RTAs are likely to affect domestic investment and growth in future through investment rules and intellectual property arrangements.

■ Jayati Ghosh is a Professor at Centre for Economic Studies and Planning, Jawaharlal Nehru University (JNU) New Delhi, India

# What are the Big Four up to in Asia?

Murray Gibbs and Swarnim Waglé

Since January 1995, about 130 Free Trade Agreements (FTA) have been notified to the World Trade Organization (WTO). There are two facets to this proliferation: At the outset, the establishment of the WTO (and its single undertaking) has facilitated the expansion of FTAs by setting common trade obligations, particularly disciplines on non-tariff measures; and on the other hand, setbacks in advancing the multilateral agenda have created new outlets for consideration of bilateral and regional options. Asia-Pacific has been the latest region to catch up with the trend and its countries are exerting renewed efforts to both deepen and expand regional and sub-regional economic integration, as reflected by a remarkable scale of negotiating activity under way. Notably, the world's growing and major economies - China, India, Japan and the US - have joined the free trade game in Asia with full vigour, each trying to carve out its sphere of influence with distinct political-economic strategies.

## China

China's first FTAs were with the Special Administrative Regions of Hong Kong and Macau in 2003 supplemented in depth by comprehensive economic partnership arrangements a year later. China entered into a framework agreement with ASEAN as of 1 July 2003. An Early Harvest agreement includes all ASEAN countries in principle, although some negotiated exclusion lists. China has negotiated an Early Harvest list with Pakistan in May 2005 and has completed FTA negotiations with New Zealand, its first FTA with an OECD country. It is also negotiating with other trading partners outside its region: Australia, Chile, Peru, Iceland, the Southern African Customs Union (SACU) and the Gulf Cooperation Council (GCC). Most importantly, China is making overtures to Japan, Korea and India, seemingly positioning itself to become the hub of the largest FTA ever.

We find that the central element of China's FTAs is that its FTA partners agree not to apply those provisions contained in its terms of accession to the WTO, which permit WTO members to impose discriminatory restrictions against China that would otherwise be prohibited by WTO rules. These involve restrictions on textiles and clothing, 'selective' emergency safeguard action, and 'non-market economy'

criteria for anti-dumping actions. For example, the relevant provision from the Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China, which came into force on 20 July 2005, states: 'ASEAN Member States agree to recognise China as a full market economy and shall not apply, from the date of the signature of this Agreement, Sections 15 and 16 of the Protocol of Accession of the People's Republic of China to the WTO and Paragraph 242 of the Report of the Working Party on the Accession of China to WTO in relation to the trade between China and each of the ten ASEAN member states.'

## India

India has accelerated the sub-regional integration process beyond SAFTA by negotiating FTAs with four of its five immediate neighbours: Nepal, Bhutan, Bangladesh (negotiations underway) and Sri Lanka. Recently, it also took new initiatives at the intra-regional level by signing a Draft Framework Agreement for an FTA with ASEAN, under which an FTA has been negotiated with Singapore and Thailand, which has already resulted in an Early Harvest Scheme covering a modest number of products. India is a member of BIMSTEC. In the inter-regional context, India has been a member of the Global System of Trade Preferences among Developing Countries (GSTP), and has signed a Preferential Trading Agreement with the Latin American Southern Cone Common Market (MERCOSUR).

A major highlight of some of India's attempts at economic cooperation is in terms of broadening of scope and emphasis ranging from trade to investment cooperation and services. Intensive work is being done on issues like rules of origin, Mutual Recognition Agreements (MRAs), anti-dumping provisions, revenue compensation mechanism, safeguards, dispute settlement modalities, etc. In short, India has placed considerable emphasis on making the present-day agreements as comprehensive as possible. We find that India has adopted a 'coalition-building' strategy, preferring to enter into framework agreements with developing-country sub-regional groupings within and outside the Asian region, including ASEAN, MERCOSUR and SACU, rather than with their individual members. Its recent overtures to discussing



Short-term incentives in RTAs leading to long term risks!

possible FTAs with developed countries such as the EU and the US could be limited to services, a possibility foreseen in Article V of the WTO's GATS.

## Japan

Japan had traditionally been a strong advocate of multilateral trade liberalisation, and an opponent of regional trade agreements. The Government White Paper on International Trade 1999 'grudgingly' admitted the positive aspects of regional trade agreements of complementing and improving the multilateral trading system. It was only in 2000 that Japan fully embarked on its dual-track policy - as witnessed by its speedy negotiation of the Japan-Singapore FTA (JSEPA). Singapore was a strategic first choice - it has negligible tariff protections and agricultural exports to Japan, which meant that political opposition to the deal, would be less significant. The Japan-Singapore FTA was used as a tactic to 'soften up' those interests in Japan which were opposed to moving from strict commitment to multilateralism.

Following this strategy, Japan is negotiating FTAs with other ASEAN countries. An FTA has been reached with Thailand and negotiations are underway with Malaysia, Indonesia and the Philippines. An FTA was reached early with Mexico to enable Japanese exporters to compete on an equal basis with Mexico's other FTA partners, notably in NAFTA and the EU. Japan is pursuing an FTA with Korea, but has remained cool to the idea

being promoted by China of a trilateral FTA among the three countries.

Japan has encountered difficulties in agreeing to free trade in sectors that it deems sensitive chiefly agricultural products. Rice was excluded from the Thai-Japan FTA, even though it is Thailand's largest export item and very stringent rules of origin were imposed on fishery products. This resulted in reduced concessions in favour of products of export interest to Japan. Other potential FTA partners might not accept such exclusions. These considerations have led Japan-the world's second largest economy-to adopt a flexible and pragmatic approach to FTA negotiations. While future FTAs would be based on the FTA with Singapore, 'Singapore-plus' and 'Singapore-minus' agreements could be contemplated. Also sensitive to Japan is the liberalisation of movement of natural persons. In the negotiations with the Philippines, where labour remittances are of crucial importance, there appears to be a wide gap between the offer of Japan to allow entry to a few hundred health care and IT professionals and that of the Philippines, which is requesting quota-free entry for these occupations. Energy security is also a priority — Japan is seeking security of supply commitments in its FTA negotiations with Indonesia, a member of the Organization of Petroleum-Exporting Countries (OPEC).

*Contd. on page 20*



# RTAs and BTAs Present many Challenges

**Centad:** There has been an explosion in the number of Regional Trading Agreements (RTAs) and Bilateral Trading Agreements (BTAs) being signed by almost all countries. In this context, do you think civil society trade policy debates are becoming largely WTO centric and have ignored RTAs? What in your opinion are the broad implications of proliferation of RTAs on development?

**Jo Leadbeater:** There is of course a considerable overlap between WTO multilateral rules and the provision in RTAs, since RTAs are supposed to be WTO-compatible. As a result developing countries involved in, and civil society organisations interested in, RTA negotiations need to follow both the WTO and RTA negotiations. The real concern for developing countries and civil society is when rich countries push for agreements on trade in goods, and trade-related areas that go further than what has been negotiated and agreed at the multilateral level. Throughout the Doha Development Agenda negotiations, many civil society organisations have been following RTA negotiations like the US-CAFTA negotiations and EPAs, but like many developing countries, civil society organisations have finite resources or they have to prioritise. The WTO has so far been the main focus of civil society organisations interested in trade. Now, civil society organisations are increasingly focusing on debates around RTAs, as many RTAs are beginning to reach critical stages in the negotiating process.

**Centad:** There is a view that in areas such as TRIPs and Investments, RTAs and BTAs are actually succeeding in pushing through the back door, what the WTO has not been able to achieve so far. What is your take on it?

**Jo Leadbeater:** Many RTAs dealing with intellectual property rights have more far-reaching provisions than those found in the WTO and TRIPS Agreement, for instance, in the manner in which they address transition periods (shorter than those under the TRIPS Agreement) and enforcement. RTAs that mandate compliance to international accords (such as the Patent Co-operation Treaty) indirectly embody features of those agreements, such as procedural requirements that, are not contained within the TRIPS Agreement. RTAs also engage countries that are not yet WTO members. This might



*Jo Leadbeater, an articulate campaigner on trade and development, talks to Centad on RTAs*

occur in respect of regional laws or policies dealing with labour mobility and intellectual property rights.

**Centad:** What are the key advocacy challenges for Oxfam GB in the coming days and months for ensuring that RTAs and BTAs are as much under public scrutiny as the WTO with the objective of ensuring that trade does indeed sub-serve development and does not become an end in itself?

**Jo Leadbeater:** RTAs and BTAs present many challenges for Oxfam GB. Firstly, unlike the WTO, there just isn't one negotiating process on which to focus — there are many. This requires an understanding of numerous processes, specifically the key political and economic concerns and objectives for negotiating parties, as well as the status of the negotiations. In campaigning terms, RTAs and BTAs present the challenge that there is no single event to focus campaign activities on, as there is in the case of the WTO with the Ministerial meetings. However, they do present opportunities for developing creative and innovative approaches to national and global campaigning.

■ Jo Leadbeater is Head of Advocacy, Oxfam GB, Oxford, UK.

## South Asian Free Trade Agreement: Opportunities and Constraints

Indra Nath Mukherji

### Background

The South Asian Preferential Trading Arrangement (SAPTA), precursor to the South Asian Free Trade Agreement (SAFTA), was signed in April 1993 and launched in December 1995. SAPTA, as the name suggests, was the mildest form of a Regional Trade Arrangement (RTA), accommodated under an Enabling Clause (as embodied under 1979 Decision) of the GATT/WTO Agreement.

Under SAPTA as many as four rounds of negotiations were concluded on a product-by-product basis. Based on a Positive List approach of offer and request list between bilateral pairs of Contracting States (CS), the negotiations were, by their very nature, protracted and time consuming. Moreover, the adoption of a 'product coverage' approach rather than a 'value coverage' approach meant that no serious effort was made to negotiate products that were intensely traded or, in many cases, not traded at all! No wonder the intra regional trade among CS continued to remain low, hovering around five percent of their total trade.

In view of the limitations of SAPTA process outlined above, it was but natural to transform SAPTA to SAFTA, the next higher level of regional integration. The signing of the Framework Agreement at the 12th SAARC Summit at Islamabad on 6 January 2004 was a major milestone in the progress towards a free trade area in the region. The Dhaka Declaration of 13 November 2005 stated that the agreement would enter into force from 1 January 2006 after the completion of a number of prerequisites underlining the agreement. Since it took more than the expected time to sort out the modalities, the agreement is now targeted for implementation with effect from 1 July 2006.

### Fulfilment of Modalities

The fulfilment of the modalities or the agreed prerequisites for the implementation of the agreement as stipulated under the Framework Agreement, have been finally incorporated as Annexure in the SAFTA Treaty.

### List of Sensitive Products

Article 7.3 of the Framework Agreement, which entailed that all CS were to negotiate a Sensitive List in respect of which Trade Liberalisation Programme (TLP) would not apply, has

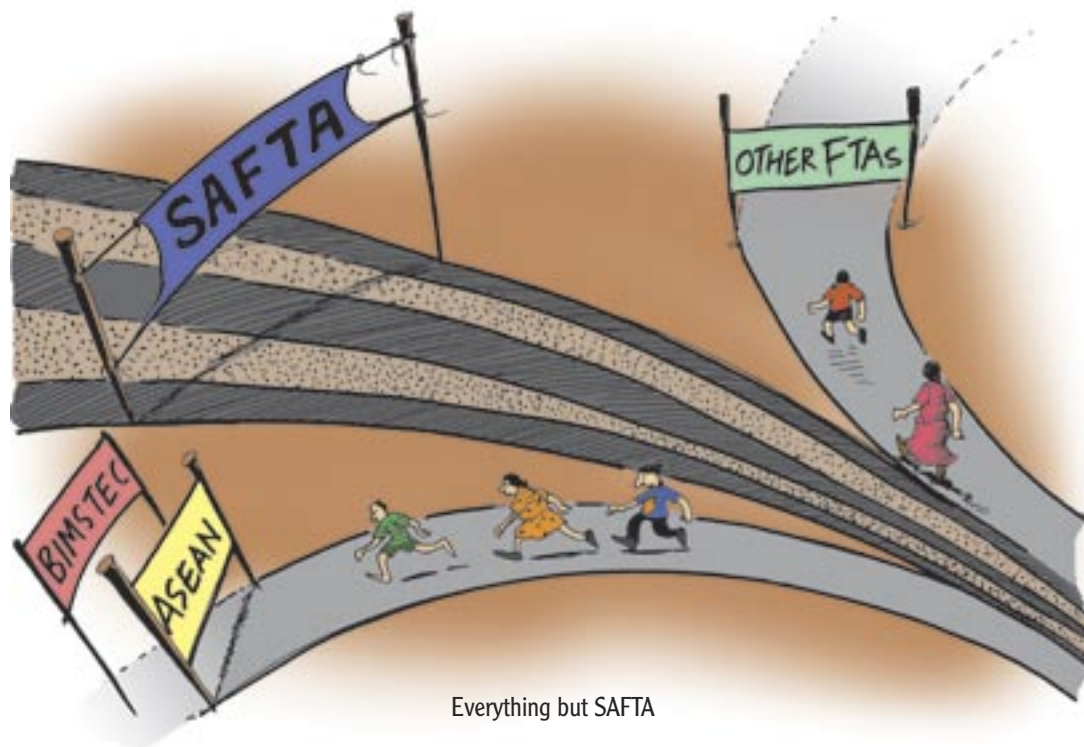
now been incorporated under Annex I of the agreement. Bangladesh has negotiated a list of 1254 products for Non-Least Developed Countries (Non-LDC) and 1249 for Least Developed Countries (LDC). India has negotiated a list of 884 products for Non-LDC and 763 products for LDC. Nepal has negotiated a list of 1323 products for Non-LDC and 1338 for LDC. Bhutan, Pakistan and Sri Lanka have negotiated a single list of 157, 1183 and 1065 products respectively.

The large list of sensitive products clearly reveals how the protective sentiment dominates most countries' TLPs. Besides, a cursory look at the sensitive lists of Bangladesh and Nepal reveals that most of the products in the two lists are not only common, but also that the list for products applicable for LDCs is in most cases, larger in number. Ideally, efforts should have been made to have a much shorter list for LDCs and also to make the two lists mutually exclusive with one list applicable to all CS and the other applicable exclusively to LDCs (as in the case of the National List of Concessions). Besides, both Pakistan and Sri Lanka have made no effort to differentiate their Sensitive Lists with respect to Non-LDCs and LDCs.

### Special Assistance for Least Developed Countries

Under Article 11(d) of the agreement, it was provided that special consideration is given by CS to requests from LDCs for technical assistance and cooperative arrangements, designed to assist them in expanding their trade with other CS. A list of possible areas for such technical assistance was to be negotiated and incorporated in the agreement. This has since been incorporated under Annexure II of the agreement.

A look at Annexure II of the agreement reveals that many of the listed areas for technical cooperation and capacity building are already incorporated under Article 11 of SAFTA text relating to special and differential treatment for LDC. However, the Annexure fails to specify how the listed areas for assistance could be translated into concrete results in the absence of any indicative financial provision. The possibility of these areas of cooperation remaining 'best endeavour clauses' remains quite high.



Everything but SAFTA

### Mechanism to Compensate LDC for Customs Revenue Loss under TLP

Article 11 (e) of the Framework Agreement further postulated an appropriate mechanism to compensate the LDCs for their loss in customs revenue following TLP. A mechanism for revenue loss compensation to LDCs has been established in Annexure III under which Non-LDCs CS will provide compensation over a period of four years from the implementation of TLP to LDCs members for loss in customs revenue on imports of non-sensitive products.

The payment of compensation for customs revenue loss under SAFTA appears to be a unique element not noticeable in any other RTA. From the point of view of Non-LDC CS the incidence has been moderated by prescribing a ceiling on the compensation and also by limiting the incidence for four years only. From the point of view of LDCs the obtaining of compensation is conditioned by providing appropriate and timely data on such imports and customs tariff data.

### Rules of Origin

Finally, Article 18 of the agreement further stipulated that Rules of Origin (ROO) be determined by the CS and incorporated as an integral part of the agreement (now incorporated under Annexure IV of the agreement).

The Committee of Experts at its 12th Meeting held in Kathmandu from 29 November to 1 December modified the SAFTA Rules of Origin (ROO). Under SAPTA, the ROO laid only one-dimensional

measure i.e., value addition criteria, to determine the nationality of the product seeking preferential entry in the regional market. Under the modified rules, products originating in exporting CS now need to meet the twin criteria of (i) minimum value addition, as well as (ii) Change in Tariff Heading (CTH). Under the first criteria, products processed from imports from third countries do not exceed 60 percent of the FOB value of the products produced within the territory of the exporting CS. Under the second, it is required that the final product being exported from the contracting exporting state is classified in a heading at the four digit Harmonised Coding System (HCS), differently from those in which all the non-originating materials are classified. A more favourable ten percentage point preference is given for LDC CS. The modified ROO also provides for product specific ROO on 191 products with 25 to 40 percent domestic value addition at the six digit HCS.

By making the criteria for originating products more rigorous, an attempt has been made to see that TLP does not lead to trade deflection, which is a major problem prevalent in many preferential trading arrangements.

### Opportunities and Constraints

South Asia, with a population of 1.3 billion, has been experiencing a GDP growth rate of six to seven percent over the last five years. It has an increasing middle class estimated around 400 million. Currently, the intra-regional trade is US\$ 7 billion as against world trade of US\$ 350 billion. All these

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## Aid for Trade – Making the Pennies Count

Robin Koshy

The highlands of Papua New Guinea grow high-grade Arabica coffee that accounts for about 40 percent of the country's agricultural export earnings and supports the livelihoods of nearly two million people. Despite commanding a premium in several markets, efforts to boost exports and diversify to other markets have not been very successful. Long-term decline in global coffee prices has had a key role, but the larger problems have been within the borders. Decrepit rural roads and ports add to transportation costs and lead to products rotting before they arrive in international markets.

Despite the warts, the current phase of multilateral trade liberalisation has created tremendous opportunities for developing countries to harness gains from trade for economic growth and poverty reduction. However, supply side constraints such as those faced by the coffee farmers of Papua New Guinea restrict the potential benefits to poor countries. Aid to enhance the capacity of developing countries to trade has been a carrot to entice hesitant developing and least developed countries (LDCs) since the Uruguay Round. From the Marrakesh Agreement in 1994 to G8 leaders meeting in Gleneagles in June 2005 and the recent World Trade Organization (WTO) Ministerial Meeting at Hong Kong in December 2005, aid for trade figures prominently. Yet, considerable divergence of views exists on the modes, sufficiency, efficacy and focus of aid for trade.

### Why Aid for Trade?

There are numerous economic and political arguments that make a valid case for 'aid for trade'. From an economic point of view, multilateral trade liberalisation can be characterised as a global public good, where the benefits are not necessarily enjoyed by the country undertaking reforms. In such a scenario, a poor country is likely to have less capacity to garner the benefits of freer trade than a rich country.

Moreover, most developing countries have a skewed dependence on tariffs for fiscal revenue and lowering tariffs as part of the trade reform process can lead to severe resource crunch in the short run. A recent IMF study<sup>1</sup> suggests that even if such tariff reductions are accompanied by fiscal reforms to mop up revenue from other sources, low-income countries (including China and India) do poorly in terms of making good the loss of tariff revenues. The empirical analysis in the study suggests that for every \$1 lost in tariff revenues, low-income countries recoup only 30 cents through fiscal reforms. Costly monetary policy adjustments are also required to adjust overvalued exchange rates that make the exports of many developing countries uncompetitive in the international markets. While the short-term costs of these adjustments might be diminutive when compared to long-term benefits, few poor countries can afford such a perspective. Countries that are already burdened by debt and resource constraints to spend on basic development priorities such as health, nutrition and education might lose the appetite for trade reforms if their adjustment costs cannot be written off.

Moreover, higher international prices of food products due to reduction in protection and subsidisation of food commodities could lead to a decline in the terms of trade of net food importing countries. 45 of the 49 LDCs import more food than they export<sup>2</sup>. Although many of the LDCs would benefit from liberalised markets for their agricultural exports, say, cotton for Cote d'Ivoire and Mali, the net beneficiaries (farmers) and the net losers (urban poor) are different. The social compensation mechanisms to insure the losers are often lacking or partial in the South and the disparities that result build social pressure against trade. Besides, investment and competition policies and a facilitative business environment that could enable countries to reap the opportunities that freer trade presents are also usually inadequate. At the global level

<sup>1</sup> Baunsgaard, T. and Keen, M., 'Tax Revenue and (or?) Trade Liberalisation, IMF Working Paper 112, 2005

<sup>2</sup> Panagariya, A., 'Agricultural Liberalisation and the Developing Countries: Debunking the fallacies', 2004



too, winners and losers are often different countries. Erosion of preferences, guaranteed by initiatives such as Generalised System of Preferences (GSP), Everything But Arms (EBA) or textile quotas also creates pockets of resistance to multilateral trade liberalisation.

However, supply side constraints such as poor infrastructure (roads, ports etc.), high transportation costs and border clearance bottlenecks (weak customs institutions and corruption) pose some of the greatest barriers to trade becoming the engine of growth for many low-income countries. An UNCTAD study indicates that transport costs of landlocked African countries accounts for an average of 21 percent of the value of imports as against a global average of 5 percent.<sup>3</sup> To free resources for such trade facilitation measures is a priority that most developing countries acknowledge, but few can afford.

Politically, the distributive and redistribute dimensions of multilateral trade that could enrich some and impoverish others could drive wedges within as well as between developing countries. Many developing countries also struggle to assemble adequate negotiating capacity to protect their national interests at multilateral negotiations and often end up signing agreements without realising the burden that commitments would impose.

In her 2005 paper enhancing aid for trade, Susan Prowse draws an interesting parallel between the need for aid to salvage trade integration under WTO and the post-World War II Marshall Plan that was instrumental in weaning Western European countries away from isolationism into multilateral trade. In as much as the Marshall plan enabled global economic recovery and a positive popular perception about integration, aid for trade could contribute to containing disenchantment amongst low-income countries about multilateral trade. Further, she identifies aid as being critical to weakening the current fad for preferential trade agreements (PTAs) and strengthening the 'policy bias' towards multilateral trade liberalisation. Many PTAs, especially the ones between developed and developing countries, lock members into conditionalities more stringent than those required in WTO Agreements ('WTO plus clauses'). If one analyses the rapid growth in the population of PTAs since 1995, aid is indeed necessary to stem the perverse incentives for regionalism that could hurt developing countries in the long run<sup>4</sup>.

## Enhancing Current Aid for Trade Mechanisms

Prowse points out that aid is required to support low-income countries at the domestic level and at the global level. Firstly, at the in-country level, aid could enable greater coherence between national development strategies and trade and investment policies. National Poverty Reduction Strategy Papers (PRSPs) could be strengthened to prioritise policy and action on supply bottlenecks that impede trade as well as pro-poor distribution measures that compensate for inequitable gains from trade. Secondly, at the multilateral rule making process, aid could be part of the special and differential treatment for low-income countries that accommodates for the challenges that these countries face in implementing current WTO obligations and harmonising domestic regulatory regimes. She advocates an issue-based approach that would provide a framework for donors and recipients to prioritise trade agenda within the overall national development strategies.

Do current mechanisms adequately echo such an approach? The Integrated Framework (IF) for Trade-Related Technical Assistance for LDCs is one mechanism that LDCs have access to. However the Diagnostic Trade Integration Studies (DTIS) have been criticised for being done 'for' LDCs by donors rather than being done 'with' them. Consultation with civil society and private sector players within these countries has not been a strong feature of DTIS. The absence of an assured funding mechanism to take up priorities identified by the DTIS has been another failing.

A joint paper by the International Monetary Fund (IMF) and World Bank (WB) 'Doha Development Agenda and aid for trade' that proposes an enhanced IF echoes many of Prowse's arguments. The paper agrees with her proposition that the volume of aid for trade needs to increase and that instead of inventing a new fund or mechanism, aid should be channelled through or in line with existing structures like the IF. It opposes the idea of a separate fund to aid capacity building programmes identified by IF. It calls for greater leadership on trade within LDCs and increased coordination amongst donors on trade priorities. Assistance would be provided to LDCs to develop project proposals for donor funds around needs identified by DTIS. Crucially, funds would also be available for multi-year rolling programmes to build the capacity of trade-related

*Contd. on page 27*

<sup>3</sup> UNCTAD, 'Report on the Least Developed Countries', 2004

<sup>4</sup> Koshy, R, 'A Case for Break-up – 'Reviewing Regional Trade Agreements'', Trading Up Vol.1-Issue 2, 2005



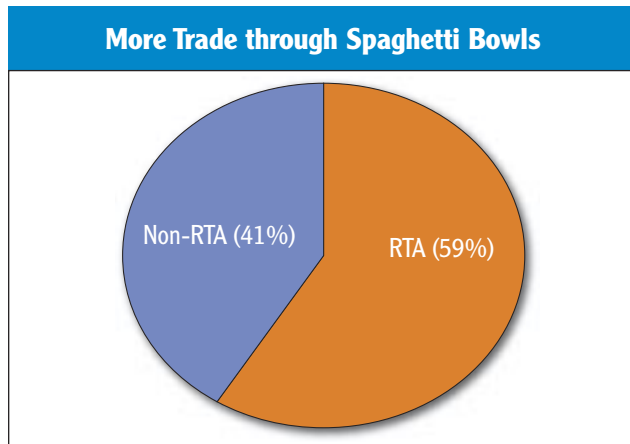
## Glaring Facts

Centad Team\*

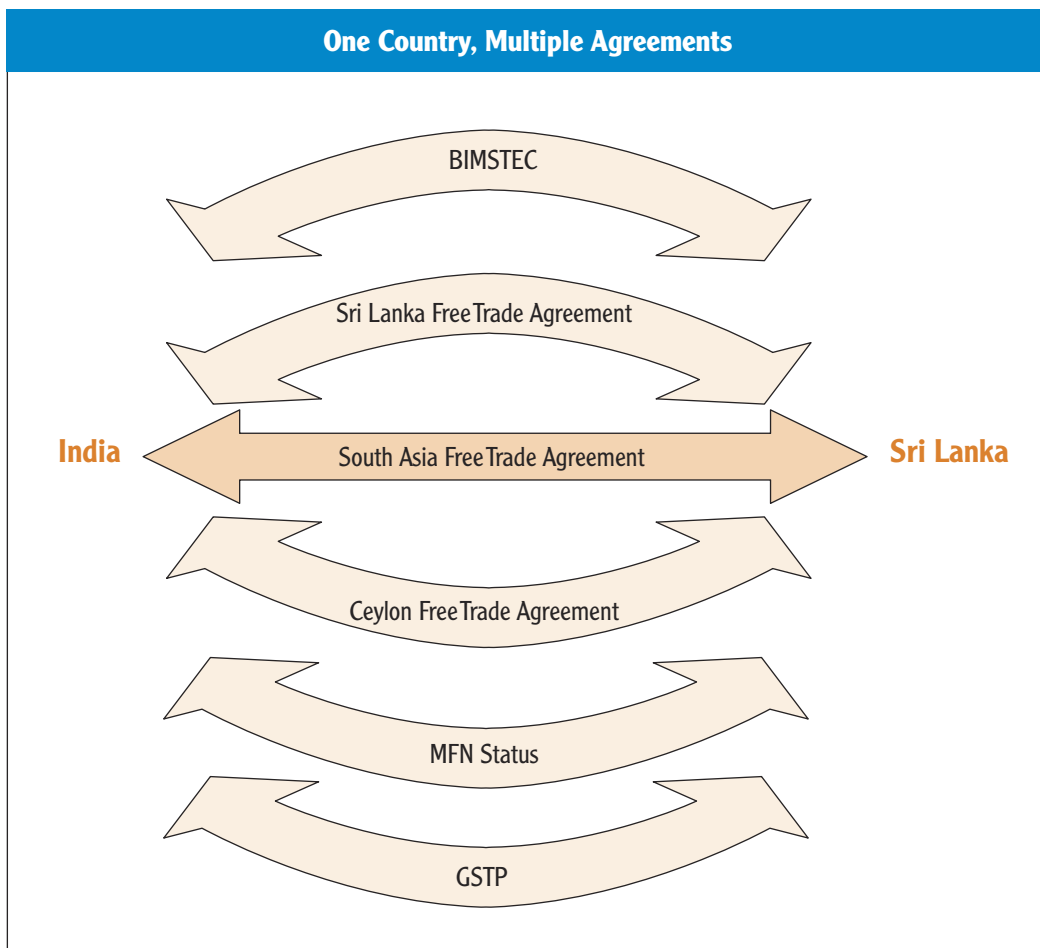
### The New Trade Imperialism

Coverage of US trade agreements:	>	75 percent of WTO members
Coverage of EC trade agreements	>	85 percent of WTO members

Source: Based on data from USTR and DGTrade European Commission (2006)



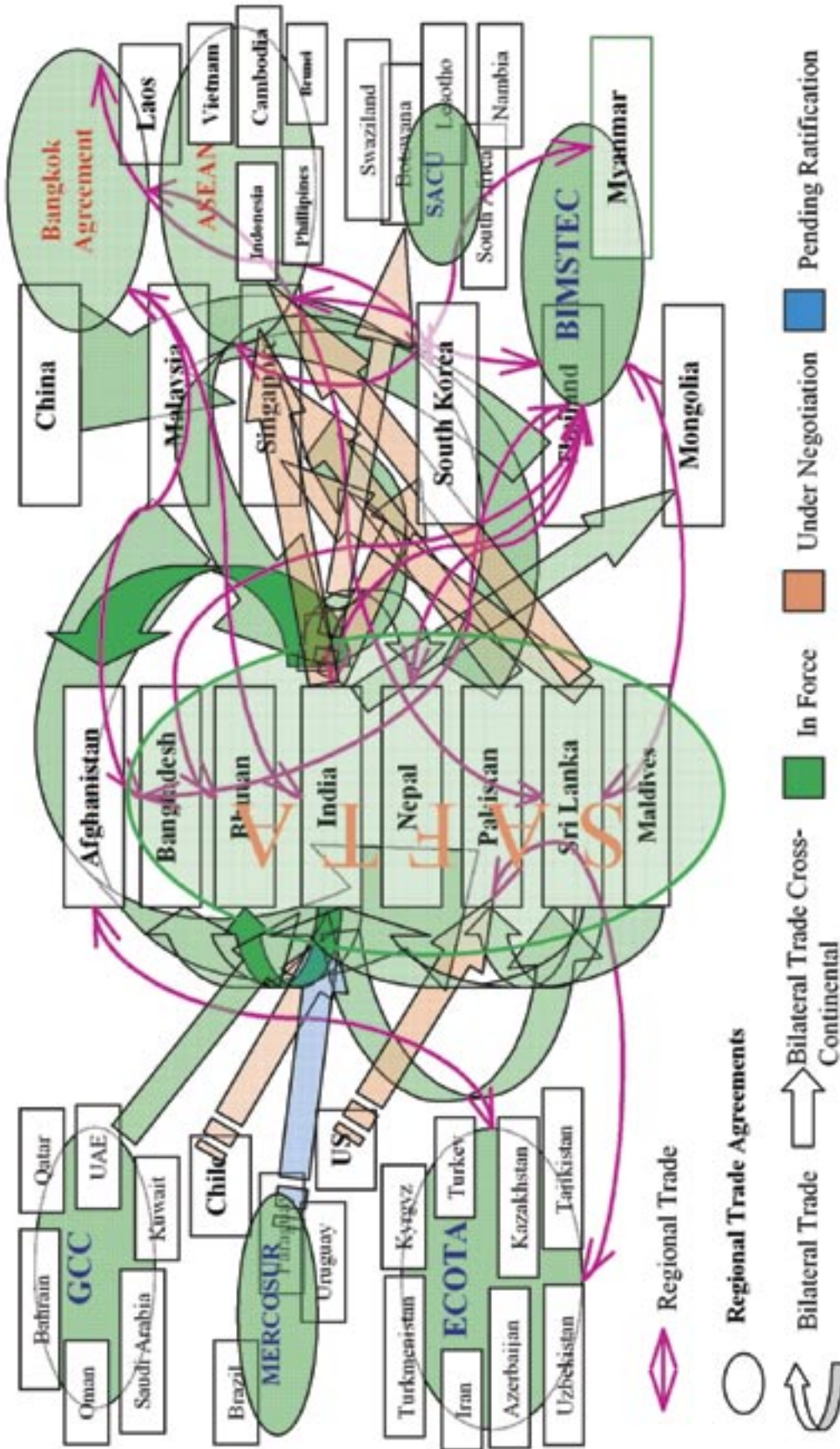
Source: Based on data from OECD (2005)



Source: Based on data from Ministry of Commerce, Government of India

\*Centad team for Trading Facts comprises Parashar Kulkarni, Linu Mathew Philip and Kasturi Das

The Spaghetti Bowl of South Asia



Source: Based on data from UNESCAP (2006)

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## The Non-trade Content of Trade Agreements...

### United States

Since 2001, the US has negotiated FTAs with Chile, Jordan, Singapore, Bahrain, Australia, Morocco, Oman, Dominican Republic and Central American states and has engaged in negotiations with other countries (e.g., Thailand and South Korea) and sub-regional groupings (e.g., SACU and the Andean Group). If all of these negotiations are successfully concluded, the number of FTA partners will increase in a few years from the original three (Canada, Israel and Mexico) to at least two dozen. The US has also undertaken an Enterprise for ASEAN Initiative that could produce a series of new FTAs in South-East Asia; it has also proposed FTA negotiations with the rest of the Middle-East. In these FTA negotiations, the US seeks that its partners accept a more or less standard model aimed at achieving clearly defined systemic and sectoral objectives; in addition, its choice of partner is strongly dictated by strategic foreign policy objectives, rather than by the value of the trade involved.

While its neighbours in NAFTA account for one-third of the US exports, the other FTA candidates are much smaller partners. FTAs seem to be employed to influence other partners in larger negotiations — for instance, the Free Trade Area of the Americas (FTAA) — or WTO negotiations, and to establish precedents that consolidate the US position on issues where it has serious differences with its trading partners (such as on genetically engineered crops, geographical indications or audio-visual services). FTAs are also used to assist US industries in transition, support countries that cooperate with the US in the fights against drugs and terrorism and encourage partners in other foreign policy initiatives. The US is actively employing FTAs as a tool of coalition building and coalition busting. The sizeable majority of US FTA negotiations, initiated since 2001 are with countries that fall into one of the two categories. The first consists of Middle-Eastern countries that cooperate with the US in the regional peace process. The US reached FTAs in the past with Israel and Jordan and has recently concluded agreements with Morocco, Oman and Bahrain. The second larger category consists of countries that supported the US war efforts in Iraq by participating in the 'Coalition of the Willing'. For instance, all countries in Latin America that joined the Coalition have become FTA negotiating partners.

The US has also used FTAs as a mechanism for structural adjustment in the textiles and clothing industry. It recognises that it cannot indefinitely sustain a large apparel industry because of its labour-intensive nature, but hopes to maintain market opportunities for textile fibres (especially cotton) and producers of fabrics. Several key initiatives have been designed to promote a soft landing for apparel producers by encouraging offshore production, while also crafting yarn forward rules of origin that support the use of US fibres and fabric in the offshore facilities. Only Israel and Jordan have escaped the yarn forward provision in their FTAs. The preferential trade programs offered to the Caribbean Basin, Andean partners and sub-Saharan Africa have been designed to set up captive markets of this nature. Under this approach, trade with the US is promoted at the expense of Asia especially China. The US also appears keen to circumvent the constraints of the WTO by incorporating systemic issues in the FTAs. The most significant, particularly from a human development angle, is the inclusion of TRIPS plus provisions as well as the pursuit of strong disciplines for investment, anti-trust, labour and environmental standards and trade in services, including electronic commerce and audio-visuals.

In conclusion, Asia is witnessing the beginnings of the twin phenomena of deep North-South bilateral FTAs and wide South-South Regional Trade Agreements. While it is too early to speculate about the likely long-term developments, the emerging trend offers broad guidance for countries in the Asia-Pacific. The onus lies on the national constituency to identify and articulate the trade motivations behind FTA and it is in this regard that the role of non-state institutions to demystify the technical trappings of trade policies assume significance. The low-income countries, in particular, should proceed warily into asymmetric bilateral trade agreements, especially with partners not in the immediate neighbourhood. They should instead expend their scarce negotiating capital in furthering regional integration efforts to secure fair and universally acceptable multilateral rights and obligations at the WTO that discipline trade and promote development.

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(This article is excerpted from "The Great Maze: Regional and Bilateral Free Trade Agreements in Asia," a Policy Paper issued by the Asia-Pacific Trade and Investment Initiative of the UNDP Regional Centre in Colombo, written by Murray Gibbs and Swarnim Wagle. The views are of the authors, and not of UNDP.)





# The Expanding Horizon of RTAs in the Multilateral System

Centad Team\*

## Are RTAs Legally Compatible with the Multilateral Trading System under the Aegis of the WTO?

Typically, RTAs are compatible with the WTO. However, this is not on account of compatibility of objectives, but as a result of special exceptions provided in the WTO. One of the core principles, under whose aegis the multilateral trading system (for the most part, the WTO) is based, is the 'Most Favoured Nation' (MFN) clause, which essentially calls for non-discrimination on part of one member country of the WTO towards all other WTO members. In contrast, RTAs are concerned with the discriminatory removal of trade barriers among the participating countries. For the purpose of providing an exception to RTAs from the WTO's MFN principle, the General Agreement on Tariffs and Trade (GATT) provides for certain exceptions that allow for such discriminatory trade policies. The major exceptions pertaining to this are contained in Article XXIV of the GATT permitting signatories to set up regional FTAs and Customs Unions (CUs) for trade in goods; Article V of the General Agreement on Trade in Services (GATS) for services; and the Enabling Clause providing legal cover for Preferential Trade Agreements (PTAs) that benefit developing countries. However, each of these clauses contain conditions that need to be fulfilled before the exception can be used. One of the conditions is that the RTA should not result in the reduction of market access for non-parties of the RTA. Though member countries have notified most of their RTAs to the WTO under these clauses, a review to really examine the degree of compatibility to the three clauses has been long pending.

## How did RTAs Evolve?

Regional integration in recent history can be traced to the Benelux Customs Union between Belgium, Luxembourg, and the Netherlands in 1944 (effective 1947). The trend continued to spread widely, notwithstanding the emergence of a multilateral system of trade relations embodied in the

GATT 1947. Post WW II economic history is witness to two distinct waves of economic integration. The first phase, dubbed the 'first regionalism', spanned over the 1950s and 1960s, when regional integration initiatives were undertaken primarily in Europe and in Latin America, with a sprinkling of arrangements in Africa and Asia. Integration efforts were mostly confined to North-North or South-South countries. The signing of the Treaty of Rome in 1957 led to the formation of the European Economic Community (EEC) in 1958, which marked the beginning of a process of central importance to regionalisation of the world economy. In North America regionalism remained virtually non-existent, with the USA showing a strong commitment to the multilateral approach. With the exception of Europe, this phase of regionalism mostly faded out from the rest of the world for diverse reasons.

The 'second regionalism' emerged in the late eighties and had its starting point in North America. The most important development was the turnaround of the US philosophy from an ardent defender of multilateralism to a staunch votary of regionalism. This period saw not only a sharp rise in the number of RTAs, but also a marked change in their profile. RTAs were traditionally forged between 'natural trading partners', which were geographically contiguous regions. But in the most recent phase, both region-specific and cross-regional trade arrangements, are spanning every corner of the globe while their configurations are becoming ever more complex. Almost all the major countries of the world are now participating in FTAs, CUs and partial scope agreements.

There are overlapping arrangements as well as networks or clusters of RTAs, agreements wherein each party is a distinct RTA (example, EC-MERCOSUR, EC-GCC EC-SACU, etc). Agreements between developing and developed countries are also on the rise (NAFTA, ASEAN FTA) as also developing country partnerships (SAFTA).

\* Centad is grateful to Moana Bhagabati, Assistant Professor, Madras Institute of Development Studies, Chennai for providing substantial contribution in writing this section.

## Currently, How many RTAs Exist — Has there been a Spurt of RTAs in Recent Times?

As of June 2006, 197 RTAs notified to the WTO are in force, and the total number well exceeds 300 if the RTAs that are being negotiated, those at the proposal stage, and the ones signed but not yet in force, are taken on board. The number of RTAs notified to the GATT and subsequently to the WTO is a clear indication of the phenomenal growth in the recent past: while between 1948 and 1994, the number of RTA notifications (for trade in goods) was 124. Since the birth of the WTO in 1995, approximately 250 new RTAs have been notified. Nearly all the members have notified participation in one or more RTAs. Some are signatories to twenty or more! According to a rough estimate, 60 percent of world trade is now covered by regional pacts. This lends credence to the current contestation that regionalism has emerged as a force parallel to multilateralism under the aegis of the WTO in the world trading regime.

## What are the Main Reasons for Growth of RTAs?

Much of the renewed interest in regional trading initiatives in the recent past can be attributed to a series of contemporary politico-economic events. The move towards a Single European Market for goods, services, capital and labour, in the late eighties, have led to concerns of a 'Fortress Europe'. Apprehensive of finding themselves in less-than advantageous access to this large market, several non-members sought membership to the Community. Around the same time, perhaps spurred by similar concerns, the role of the US in forging regional ties (first with Israel in 1985, then with Canada in 1988, expanded to form the NAFTA in 1994) marked a watershed in the revival of regionalism. These developments, coupled with continued difficulty of successfully concluding the Uruguay Round (UR) of Trade Negotiations (1986-94) conditioned the response to regionalism in Latin America and the Asia-Pacific, with many countries entering into preferential agreements against a likely failure of the UR. The immediate rationale behind the proliferation of RTAs in the more recent past (there are over 50 notifications after 2004) may be sought in the sorry state of affairs of multilateral trade negotiations under the Doha Round. More and more countries are now taking recourse to the regional arrangements as a faster and more easily negotiable alternative to the multilateral route.

## What are the Common Motives Behind RTAs?

The motives underlying RTAs vary from one group of countries to another. Traditional trade gains, driven by access to larger markets are the most conventional objective. Some countries also seek trade arrangements as a means to increase their bargaining power towards third world countries. This is especially true of the countries involved in the formation of the EC as also of the Latin American integration. Another rationale is the actual or potential use of regional agreements for tactical purposes by countries seeking to achieve their multilateral negotiating objectives. Apart from the economic factors (the traditional basis for RTAs), political and security considerations also appear to increasingly motivate countries to seek regional integration.

## What is the Significance of RTAs for Developing Countries?

Developing countries and RTAs have a significant yet increasingly complex relationship. Increased participation in RTAs, whether through partnerships with other developing countries or with developed countries is a phenomenon to take note of. The freeing up of trade on preferential terms among a subset of developing countries may aid domestic reforms – in a classic case of self inflicted pressure. At the same time, the pace at which they open up to competitive market pressures may be more sustainable and friendly. Also in some parts of the world, many agreements come under what is known as the 'hub and spoke' effect, where a large country – say the United States – has multiple RTAs with several smaller developing countries – say in Latin America and Asia. Purely from the members' point of view this might provide greater market access to the larger prosperous partner. As an illustration of this trend, the United States has signed agreements with Chile, Jordan, Morocco, exploring opportunities with Oman, and the UAE, and is negotiating with many other countries across the hemispheres. Developing country participation may also enhance competitive trade liberalization and thus benefit the multilateral process. On the flip side however, the proliferation of arrangements outside the purview of MFN may be detrimental to their interests.

In addition to the sheer number of agreements which have come into existence, many countries have sought a deeper level of integration than in the past. This may even involve the creation of separate dispute settlement mechanism, as with the

NAFTA. An interesting to note that many of these arrangements are including subjects under the ‘Singapore Issues’ (Trade Facilitation, Investment, Government Procurement, and Competition), thus enlarging their scope.

The political considerations among developing country RTAs is no less significant. In the mid eighties, the MERCOSUR was formed with a political agenda, quite apart from the economic, of containing the military hostility between Argentina and Brazil. Similarly, certain African integration initiatives were undertaken for conflict resolution, and economic cooperation followed.

The trend of regionalisation among developing countries needs to be monitored, by respective governments, and at the WTO to minimize the negative fallouts which will render the economically backward even more vulnerable to damaging global pressures. With no-holds barred spread of RTAs, the very rationale – of them being more manageable tools of trading amongst smaller groups, may be belied.

### **Are RTAs ‘Building Blocks’ or ‘Stumbling Blocks’ to Multilateralism?**

This is a highly debatable issue. From a perspective that seeks to defend multilateralism, RTAs may be considered acceptable if they create new trading opportunities, do not unduly distort trade, provide momentum for non-discriminatory trade liberalisation efforts, and are open to new members. The ‘multilateralists’ or those who advocate total reliance on the multilateral process argue that RTAs divert trade very often by creating preferential treatment for inefficient members vis-à-vis non-members. Hence, RTAs are frequently labelled as Preferential Trade Arrangements (PTAs). A move towards trade diversion unaccompanied by simultaneous MFN liberalisation could lead to lopsided development. The countries not party to any RTA by choice or compulsion might get marginalized. Another concern is the attention diversion aspect, making countries involved in RTAs lose interest in the multilateral process.

The ‘regionalists’ on the other hand, counter that trade creation under RTAs is generally found to exceed trade diversion, and in that sense RTAs promote trade and development. Regional liberalisation creates incentives for individual countries to follow suit, and this can add up to the multilateral process of trade negotiations. It is further argued that the positive

effect that regionalism has or is likely to have, on politics of regional partners can ease inter-nation rivalries. There is also the argument that negotiations for free trade are more likely to succeed when conducted among three parties rather than among 149 (i.e., the number of WTO Member Countries)! Hence the debate goes on...

### **What is the Current Status of RTAs in South Asia?**

In South Asia, India is the main hub of RTA activities. However, the country has had a late start in terms of entering into regional agreements. In spite of a 1995 South Asian Preferential Trade Arrangement (SAPTA) with its SAARC neighbours (Pakistan, Bangladesh, Nepal, Bhutan, the Maldives and Sri Lanka), the transition to a South Asian Free Trade Area (SAFTA) in January 2006 took nearly a decade for the final ratification. In spite of its initial reluctance and negative views vis-a-vis RTAs, a number of agreements are still emerging. The Indo-Sri Lanka FTA (signed in 1998 operational from 2000), a Framework Agreement under BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand – Economic Cooperation), Indo-ASEAN and Indo-Thailand Framework Agreements, the Comprehensive Economic Cooperation Agreement with Singapore, apart from partial scope agreements with MERCOSUR, are some of India’s engagements in South Asia.

Notably, establishment of RTAs in South Asia is fraught with diverse problems which are often extremely complex in nature. While some of these problems are economic, others are attributable primarily to the overarching political complications cropping up between certain countries.

### **What is the Likely Future of RTAs?**

Looking at future trends, it is more than likely that the current growth of RTAs will be maintained, even increased. Of all the RTAs in existence, not all have been notified to the WTO, in particular to the Committee on Regional Trade Agreements (established 1996 with a mandate to monitor RTAs). It is expected that some of these RTAs will, in due course be notified. At the same time, membership in plurilateral RTAs is expected to rise, leading to an even more complex network, and further build-up of ‘super-RTAs’. Clusters of RTAs may act as precursors to continent-wide RTAs. In Europe, America, and Africa this trend is definitely taking shape.



## Glossary

Centad Team\*

**Article XXIV of GATT:** This Article of General Agreement on Tariffs and Trade (GATT) provides an exception to the multilateral trade obligations by allowing member states to create custom unions and free trade areas. Accordingly, the multilateral obligation under WTO does not prevent the two countries from entering into special arrangements with respect to the trade between them or to create a custom union or free trade area. However, the present debate is that whether Article XXIV can be used to justify WTO plus provisions in the regional and free trade agreements.

**Bilateral Investment Treaty (BIT):** A treaty between two countries that has been designed to promote and protect investment between the two partners. Typically, BITs offer investors national or most favoured nation treatment; free transfer of funds, as well as guarantees against denial of justice and expropriation without compensation. Unlike the WTO system, many BITs offer private entities (investors) a right to bring states to an international arbitration tribunal for settlement of disputes, with the possibility of award of damages as a remedy. However, there is a new trend in many bilateral investment treaties to necessitate parties to undertake obligations on intellectual property, competition policy and service sectors.

**BIMSTEC:** The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, or BIMSTEC, groups together Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand. The seven-country forum aims to achieve its own free trade area by 2017.

**BTA:** A bilateral trade agreement (BTA) is an agreement between two countries, as opposed to a multilateral agreement.

**CECA:** Comprehensive Economic Cooperation Agreements (CECA) are agreements signed between countries beyond trade to cover investments, double taxation avoidance, mutual recognition agreements etc. CECA between India and Singapore is structured as an integrated package of several agreements concerning Trade in Goods, Trade in Services, Investments and Economic Cooperation and a revised Double Taxation Avoidance Agreement. The CECA,

which comes into effect from 1 August 2005, is expected to benefit both the countries in the form of increased bilateral trade, investment and economic cooperation as a whole.

**COMESA:** A trade agreement involving 21 nations of eastern and southern Africa. COMESA came into effect in 1994, replacing an earlier preferential trade area. The current members are Angola, Burundi, Comoros, Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.

**Customs Area:** A geographic area that is responsible for levying its own common customs duties at its border.

**Customs Union:** A group of countries forming a single customs territory in which (1) tariffs and other barriers are eliminated on substantially all the trade between the constituent countries for products originating in these countries, and (2) there is a common external trade policy (common external tariff) that applies to non-members.

**ECOWAS:** The Economic Community of West African States is a regional group of fifteen countries, founded in 1975. ECOWAS aims to promote greater economic integration at the regional level between member countries which include Benin, Burkina Faso, Cape Verde, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo.

**Enabling Clause:** The enabling clause is officially the “decision on differential and more favourable treatment, reciprocity and fuller participation of developing countries”. It was adopted under GATT in 1979 and enables developed members to give differential and more favorable treatment to developing countries. Although it allows flexibility, including additional special treatment for least developed countries, the clause interpreted to require preferential treatment is to be generally available to all developing countries. The enabling clause is also the legal basis for regional arrangements among developing countries and for the Global System of Trade Preferences (GSTP), under which a number of developing countries exchange trade concessions among themselves.

\*This glossary is compiled from information available at the World Bank, Deardorff's Glossary of International Economics, 2006 and [www.bilaterals.org](http://www.bilaterals.org).



**FTA:** Free Trade Agreements (FTAs) are between two or more countries to create preferential trading arrangements in goods and services. Traditionally, FTAs were focused on the reduction of tariffs among the members. However, new generation Regional Trade Agreements (RTAs) are used to push the WTO plus provisions. It is observed that the increasing number of FTAs are a result of slow progress in the multilateral framework.

**Negative List:** Approach to determining coverage of products or sectors within an agreement by listing only those, which will be excluded from coverage.

**Policy Space:** Regulatory freedom advocated by governments in order to be able to adopt and promote policies adapted to their country's development needs. This demand for policy space arises as the increased liberalization of all sectors of the economy, and pressure by industrialized countries for the increasingly stringent and wide-reaching scope of WTO rules, leaves lesser room for countries to determine their own national policies.

**Positive List:** Approach to determining coverage of products or sectors within an agreement by listing only those, which will be included in coverage.

**Preferential Duty:** A tariff lower than the MFN tariff, levied against imports from a country that is being given favored treatment, under either a preferential trading arrangement (PTA), a regional trade agreement (RTA) or a free trade agreement (FTA) or under the GSP.

**PTA:** A Preferential Trade Agreement (PTA) is an agreement between a group of countries to levy lower (or zero) tariffs against imports from members. In addition, PTAs may liberalise trade in services, rules of origin, etc. This term includes FTAs, customs unions, and common markets. Prof. Jagdish Bhagwati prefers to use this term instead of the more misleading FTA.

**Regional Integration:** The formation of closer economic linkages among countries that are geographically near each other, especially by forming preferential trade agreements.

**RTA:** Regional Trade Agreements (RTAs) are generally entered to create preferential trading arrangements among member countries of a region. Like FTAs, the focus was originally on reduction of tariffs. However, during the course of time, RTAs are focusing on the economic integration of the region. Of late, agreement between a country and other countries of a different region are also called as RTAs. RTAs also contain WTO plus provisions.

**Rules of Origin (ROO):** Set of rules that determine the country in which a product is deemed to have originated. Rules included in a FTA specifying when a good will be regarded as produced within the FTA, so as to cross between members without tariff or at a lower tariff rate. Typical ROOs are based on percentage of value added or on changes in tariff heading.

**SAFTA:** The South Asia Free Trade Agreement (SAFTA) was agreed upon among the seven South Asia countries that form the South Asian Association for Regional Cooperation (SAARC): Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAFTA came into effect on 1 January 2006, with the aim of reducing tariffs for intra-regional trade among the seven SAARC members. Pakistan and India are to complete implementation by 2012, Sri Lanka by 2013 and Bangladesh, Bhutan, Maldives and Nepal by 2015.

**Spaghetti Bowl:** Term frequently used by Jagdish Bhagwati for the tangle of relationships created by multiple overlapping preferential trading arrangements.

**Trade Creation:** Trade that occurs between members of a preferential trading arrangement that replaces what would have been production in the importing country were it not for the PTA. This is associated with welfare improvement for the importing country since it reduces the cost of the imported good.

**Trade Diversion:** Trade that occurs between members of a preferential trading arrangement that replaces what would have been imports from a country outside the PTA. This results in welfare reduction for the non-member country since it loses sales to the PTA country and also may result in a loss to consumers of the importing country since it may increase the cost of the imported good.

**WTO Plus:** Many RTAs and FTAs with developed countries especially with the USA and Europe, contain provisions which obligates parties to take commitments, which go beyond the WTO obligations. For instance, parties are obligated to undertake commitments on intellectual property protection higher than that of the Agreement on TRIPS. As result, these agreements will limit the flexibility available within TRIPS Agreement. Many RTAs and FTAs with developed countries undertake obligations that go beyond GATS. As result, these agreements limit the flexibility available within GATS and TRIPS. These provisions are also known as TRIPS Plus and GATS Plus.

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## Regional Trade ...

traditional multilateral players such as India are now trying to get on the regional bandwagon. As countries like India get more deeply involved in the regional trade agreements, it will invariably soften its stand on RTA rules within the WTO.

### Conclusion

It seems that developed countries would be happy to keep the substantive rules regarding the formation and application of RTAs in the WTO as wide and as loose as possible. If the rules are wide and loose they give enough ground to play around and use RTAs to further all kinds of agenda. Given the past record of the US, whereby it first achieved things at the regional level and then easily pushed them in the multilateral level, there are strong reasons to believe that it will repeat this again with the WTO. The word of caution here is that all RTAs are not bad. The RTAs between developing countries have actually propelled South-South trade. However, the problem

areas are RTAs between developed and developing countries as discussed above.

Whatever be the economic rationale behind the formation of RTAs, there cannot be gainsaying the fact that it is the second best solution, not only to liberalise trade but also to protect the concerns of individual developing and least developed countries. The need of the hour is that all the member countries of the WTO should put in their energy to successfully complete the Doha round of negotiations and work towards strengthening the first based solution — the multilateral trading regime.

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## South Asian Free ...

indicators point to the immense potential for these countries to expand their intra regional trade now, as the path towards the goal of a free trade area and the pre-conditions under the SAFTA Framework Treaty have been defined.

The immense potential defined above however is subject to some serious constraints, some of which have already been mentioned above. First, the inclusion of a long Negative List by the CS, points to the caution with which they are opening up their economies, notwithstanding the Balance of Payment Measures (Article 15) and Safeguard Measures (Article 16) incorporated in the text of the agreement. This pre-empts a large volume of regional trade under TLP.

Second, the agreement provides for a long phase-out plan for a free trade area in the region under the TLP. The phase-out plan under TLP envisages the phase-out of customs tariffs (zero to five percent) for all non-LDCs CS in five years (2011) from the date of its implementation (2006). The phase out period is six years for Sri Lanka (2012) and for LDCs CS eight years (2014). Noting that the pace of trade liberalisation has been faster under various other competing bilateral, regional and multilateral forays, the TLP under SAFTA could most likely become both irrelevant and redundant.

Third, the non-inclusion of services similarly pre-empts a

significant share of the intra-regional trade. With the general decline in customs barriers regionally and globally, new forms of trade restrictions in the nature of non-tariff barriers are emerging, largely nullifying the space created by the former. The SAFTA Text merely provides for the notification by CS all non-tariff and para-tariff measures to their trade on an annual basis. No effort has been made to eliminate all such WTO non-compliant barriers in a phased and time-bound manner.

Perhaps one of the most severe limitations of the SAFTA Treaty is the non-compliance of MFN principle by Pakistan in respect of its imports from India, which violates Article 2 (b) of the SAFTA Treaty.

In order to be relevant, SAFTA must swiftly move towards deeper integration that characterizes most recently emerging RTA by moving beyond trade in goods. This calls for incorporating services adopting a blueprint for a SAARC Investment Area and enacting agreements/ protocols for trade and investment facilitation, many of which remain as best endeavour clauses under Article 8 (as Additional Measures) of the SAFTA Text.

■ **Reference:** <http://www.saarc-sec.org/main.php> downloaded 16-18 May, 2006.

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## Aid for Trade ...

institutions and policy making processes, and supporting supply side initiatives led by the private sector. The paper calls for a three-year trial period for such an enhanced IF during which the performance would be monitored and evaluated. There are however fears that more stringent monitoring and evaluation standards could emerge as 'Non-Aid Barriers.'

Two further propositions demand attention. Firstly, it calls for support to cross-country and regional aid for trade initiatives. This is particularly germane to small landlocked countries that are dependent on the cooperation of their neighbours. For instance, Nepal could invest substantially in improving roads to ease supply side constraints. However, unless India complements this initiative by improving roads on its side of the border and access to ports for Nepali exports, the benefits to Nepal could be minimal. Regional efforts could also be beneficial in areas such as the establishment of laboratories for conforming to standards, and power and communication networks. Secondly, it advocates for opening up access to IF funds to non-LDC developing countries too. Inclusion of new developing countries could be on the basis of detailed impact assessments that quantify adjustment costs, such as the impact of ending textile quotas. Indisputably, other developing countries require extensive capacity building support, but this proposal raises considerable anxiety amongst LDCs that they would be competing for a diminished pot of resources.

Direct budgetary support as an alternative mechanism to support trade related capacity building initiatives in developing countries with more accountable and transparent systems is another option that bilateral and multilateral donors could consider. This is likely to emerge as one of the mechanisms that donors will consider in the ongoing discussions.

### 'New and Improved' Aid for Trade

Strengthening these trade relating capacity building measures would therefore require an increase in committed funds for trade and strengthening mechanisms within developing countries to ensure targeted use of funds. The Hong Kong WTO Declaration reiterates the positions taken in the IMF-WB joint paper on the need for an enhanced IF mechanism (Paragraphs 48-51) and for improving the quality and focus of technical cooperation programmes (Paragraphs 52-54). The recommendations of the IF Task Force constituted by the WTO Director General in January are expected to contribute

to a 'new and improved' IF by December. Given the target of doubling aid for trade to around US\$ 5-6 billion by 2010, an enhanced mechanism for targeting resources is timely. This would also avert scepticism that increased foreign aid flows into small developing countries could lead to the 'Dutch Disease' of real exchange appreciation that would make exports from these countries more expensive in the international markets. Committed funds for trade facilitation and competitiveness will in fact enable them to increase their array and volume of exports. After all, trade rather than aid is the sustainable path to development for the developing world.

Critics argue that these proposals on enhancing aid for trade might be inadequate. Oxfam argues not only for an increase in aid and making aid for trade additional to development aid, but also calls for making such aid driven by priorities identified by recipient nations<sup>5</sup>. It favours grants over loan-based approaches such as the IMF's Trade Integration Mechanism that assists developing countries to meet balance of payment difficulties due to trade liberalisation. It calls for linking costs associated with new WTO commitments to additional resources and ensuring that aid is not used to coerce developing countries to accept unfair trade rules. Oxfam acknowledges that a reformed IF that truly involves all major stakeholders and all key donors at the country level could be a way forward.

The coherence between donors and trade policy campaigners in recognising the need to enhance aid for trade as well as delivery mechanisms is perhaps a good step forward. However, LDCs and developing countries need to play their roles to influence the evolving aid for trade programme. After all, aid for trade should complement the realisation of the developmental goals of the Doha Development Agenda and not be a substitute for trade liberalisation.

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<sup>5</sup> Oxfam Briefing Note, 'Scaling-up aid for trade: How to support poor countries to trade their way out of poverty', November 2005

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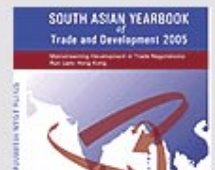
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