

Asymmetric Capabilities in Trade Negotiations: Suggestions for Helping the Smaller Economies in the FTAA Process

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The world economy has entered dangerous and uncharted waters. The technology boom that played such a large part in the extraordinary United States economy during the 1990's has, within the last 18 months, turned into a technology bust. This has caused a sharp downturn in the U.S. economy, and because the U.S. economy has been the driving force for so much global economic growth, a sharp global downturn has followed. The increased linkages between nations that characterized globalization have proven to produce a global downturn just as readily as a more virtuous cycle. No area of the world has been immune from the downturn, although China, Russia and India--each still insulated from the global economy in certain respects---have been less affected than trade-dependent countries such as Mexico, South Korea and Taiwan. For the smallest, poorest economies, struggling to provide opportunities and escape a cycle of poverty, the results of the downturn could be devastating.

At this critical juncture, many leaders recognize the need to keep markets open, and indeed, to keep lowering trade barriers through successful trade negotiations. These leaders are well schooled in the lessons of the Great Depression, and appreciate that raising the walls to trade between countries could turn the present recession into something deeper and more lasting. Unfortunately, it is a fact of life in virtually every country that economic hard times intensify the opposition to trade, as individuals and companies react to the downturn by seeking to hold the market share they have at home against competition from abroad. The political pressures to raise the barriers to trade, rather than lower them, cannot be discounted.

Moreover, of course, the advocates of expanded trade faced serious opposition even before the global downturn. The effort to launch a new WTO round in Seattle in December 1999 failed dramatically despite the relatively positive economic climate worldwide. The nations of the world fared better in launching a new round this month in Doha, but a successful outcome is years away at best, and by no means guaranteed. The Free Trade Area of the Americas---the largest regional trade expansion effort---has progressed steadily at the technical level, but the truly hard decisions and tradeoffs remain to be confronted, and a positive outcome too is by no means preordained.

Prominent among the challenges facing trade negotiators is the widely-shared view in many developing countries that trade agreements have not delivered anticipated benefits for their people. Representatives of these nations have charged that developed world advocacy of open trade is hypocritical, because of failure by these nations to open their markets fully to the most important exports of the developing world: textiles, apparel, and certain agricultural products. Much of the developing world also believes that the United States and the European Union drove too hard a bargain in the Uruguay Round, particularly in the area of intellectual property, leaving the developing world with

insufficient flexibility to address its public health concerns, particularly the AIDS epidemic. These widespread and deeply-felt views make it very unlikely that any major trade negotiation---global or regional---can succeed unless the concerns of the less developed nations are successfully addressed. This could be particularly true in the FTAA, where the 34 countries involved include so many smaller economies, and the region has been historically characterized by the world's sharpest income disparities.

Given this daunting environment, FTAA negotiators face an intense challenge of finding ways to meet the needs of poorer countries. There are, of course, significant precedents in this regard. The concept of "special and differential" (S&D) treatment for developing countries is well established in the international trading system. The concept of S& D appeared in the Tokyo Round of negotiations (1973-79) under the General Agreement of Tariffs and Trade (GATT) to serve the interests of many newly-independent countries that had just joined the GATT. Prior to the Tokyo Round, the concept of "developing nations" was realized institutionally and operatively when UNCTAD was formed in 1964 to address development asymmetries among nations. In 1964, the UNCTAD framework produced the Generalized System of Preferences (GSP) whereby industrialized nations grant "non-reciprocal trade preferences" to developing nations, albeit in partial, temporary and conditional fashion. The Uruguay Round completed in 1993 represented the most-reaching effort to recognize developing nations' need for special and differential treatment, and virtually every WTO agreement contains significant provisions for this purpose.

Negotiating Approaches

Nearly two-thirds of the countries participating in the negotiations of the FTAA are smaller and less developed countries (SLDCs). Because of the size of each economy, the general view is that none of these countries is significant enough to have real influence on the negotiations. Indeed, some believe that even collectively, the SLDCs will not have enough critical mass to influence the negotiations. In our view, these conventional judgments are overly pessimistic and historically incorrect. Smaller economies can have real influence in the negotiating process if certain principles are followed.

The first important rule for LDC negotiators---and some might argue the only important rule---is to lead. It may appear counterintuitive that small developing countries can lead a negotiation, but there are many precedents. The Cairns Group of countries has greatly influenced global agricultural negotiations, despite the enormity of the U.S. and the EU. In the 1989-1992 steel trade dispute, Austria was the country that proposed the compromises necessary to reach agreement. Singapore has been the most significant leader in the APEC process and the ASEAN Free Trade Agreement. Simply put, there is no substitute for leadership.

In this context, small developing countries should make every effort to use their chairmanships of the FTAA working groups to further their agenda. While this will involve dedicating resources to trade and to training specific individuals, the effort is worthwhile because it provides an ability to be involved directly in the negotiating process and to advance the special provisions that may be essential for smaller developing countries as a group.

The other important principle is that of strength in numbers. The SLDCs should consider negotiating as a block but voting individually, since collectively, the group would have not only more economic weight, but equally important, more voting weight. In this context, the SLDCs should consider a single trade negotiator who would lead the negotiations as well as a negotiating team consisting of members from each of the SLDCs, with each team member taking on a special function in the negotiations. In this way, the group will have a unified representative (thus reducing the possibility of dividing the group) and can draw on the specialized skill of each of the SLDC members.

This tactic will become more valuable as the 2005 deadline for concluding the FTAA draws closer. Countries will be under increasing pressure to get concessions to win approval and support at home. A unified block with a single set of demands is more likely to be placated if it means all the countries in the block will pledge their support for the agreement. This may be particularly useful with the United States and Canada, if concessions are to be negotiated in exchange for provisions on labor and the environment.

Options for the FTAA Process

Market-Opening Mechanisms

It is important for those interested in the FTAA to understand the most commonly used devices for granting special and differential treatment, to assess potential their value in this negotiation. Nearly all multilateral trade agreements incorporate phase-in periods so that no economy is faced with immediate structural adjustments. The most commonly used form of special and differential treatment for developing countries is to grant longer phase-in period for implementing trade liberalization measures. The Uruguay Round agreements take this approach repeatedly. For example, developed nations agreed to eliminate trade-related investment measures over 2 years, while developing nations were given five years to eliminate such measures. Developed nations agreed to apply the TRIPS agreement after one year; developing nations received five years, with five additional years given for certain patents. In the Asia Pacific Economic Cooperation Forum (APEC), the leaders have agreed to implement free trade in the region by 2010 for developed countries and 2020 for developing countries, thus granting a 10-year phase-in for developing countries.

Another differential method frequently used in multilateral and bilateral trade agreements with developing countries is to require less in the way of market opening measures. For example, it is possible to agree to tariff cuts for developing and least

developed countries that are smaller than for developed countries, and to allow LDCs to maintain tariffs at a higher level than developed countries can. A “free trade” area that permits some countries to maintain higher tariffs than others essentially taxes trade with those countries, putting them at a competitive disadvantage. Nevertheless, for smaller economies where the tax base and the economy are so narrow, a tariff might serve other purposes, such as a means of generating tax revenues.

Measures Affecting Market Access for SLDC Exports

Preferential treatment can also be provided with respect to SLDC exports, if larger economies implement liberalization measures earlier for SLDCs than for other countries. Such a step would be similar to GSP-type programs where imports from SLDCs would enter duty free or at preferential rates. To have the maximum positive impact, the goal should be accelerated market access for the SLDCs to all the larger economies in the region---developed and developing. Accelerated market access for SLDCs is not only appropriate for the products in which SLDCs already are principal suppliers, but it is equally important in new sectors if those SLDCs intend to expand their economic base to attract new investment. (Of course, these potential benefits often collide with practical reality: because developed nations have traditionally wanted to exclude certain sectors of great importance to SLDCs from accelerated market access, especially textiles and sugar.)

The value of such a preferential approach to exports only exists in the short term; the preferences diminish over time as other countries continue to implement market access commitments. However, the benefits of any preferential treatment would be greatest to the extent that preferential treatment was accorded in areas of tariff peaks (e.g. textiles) and in areas with tariff escalation (where tariffs are higher for products in the later production stages).

Possible Areas of New Departure

Negotiating Tariffs on Two Tracks

Part of the challenge in fashioning trade arrangements that benefit SLDCs is that while they often derive benefits from having longer times to reduce tariffs, there is often a cost as well. Many economists would argue that extending the phase-in period for liberalization only puts the SLDC economies at a disadvantage regarding other countries which implement liberalization measures early. One possible solution to this dilemma would be to divide the negotiations into two separate tracks: the first track being negotiations over applied rates which would be reduced faster, and the second track being negotiations over bound rates, which would have the longer phase-in periods. This two-

track approach would allow individual countries to undertake liberalization quicker, to the benefit of all negotiating partners, while reserving the right to rebalance rates if the adjustment process appeared too onerous for a particular sector, but only within the negotiated levels of bound rates. Under this approach, a country would be able to implement those measures without having to resort to safeguard actions.

Preferential Treatment in Additional Areas

While the Uruguay Round agreements extended preferential treatment to SLDCs in many agreements, other areas could be usefully explored. One area where differential treatment is generally not provided is with rules of origin. SLDCs could consider special modifications in the rules of origin during a transition period, which would provide an incentive for non-FTA countries, to invest and conduct more trade through the SLDCs. Variations on such differential treatment could include either a delay in implementing the rules of origin, or a different formula that would apply for the SLDCs (e.g. 40% domestic content as opposed to 50%).

Similarly, the Uruguay Round agreements went a long way toward disciplining the use of subsidies, particularly in the non-agricultural areas. But SLDCs, given their particular economic challenges, may have a greater need to use subsidies in order to encourage investment and to develop new sectors. The WTO Subsidies and Countervailing Measures Agreement allows the Least Developed Countries to use prohibited export subsidies. It should be possible to craft special provisions to meet the needs of SLDCs in other subsidy areas.

Measures Affecting Dispute Resolution

One of the most difficult challenges for the SLDCs is dealing with binding dispute resolution systems, especially the dispute settlement system of the WTO. The system is difficult for the SLDCs because their legal and technical resources are in short supply. SLDCs would benefit from “special and differential treatment” in the area of dispute resolution. One possibility would be to provide for a mediation mechanism for disputes involving an SLDC. Presently, the WTO recognizes the possibility of mediating disputes, but the mechanism is voluntary; most disputes are still resolved through the panel process of binding arbitration. For SLDCs, the mediation mechanism could be made the preferred or even required means of resolving trade disputes, thus diminishing the costly and resource-intensive legal procedures that a lengthy panel process would entail.

An alternative approach would be to level the playing field by ensuring that quality legal resources were available to SLDCs. Presently, the WTO provides legal services to member companies for a wide range of advice, including advice on dispute settlement cases. However, the WTO does not give the SLDCs legal representation in actual mediation or panel processes. It might be advisable for an organization such as the

IDB to establish an office of legal services on trade to which the SLDCs could avail themselves at all stages of the dispute settlement process, including the litigation process.

Conclusion: Linking Trade Liberalization to Economic Growth and Investment

Generally, trade agreements, whether multilateral or bilateral, have specific timeframes for implementation. Consequently, trade liberalization measures, although negotiated in periods of economic prosperity, must frequently be implemented in periods of economic slowdown or even during recession. The Uruguay Round agreements provide a recent example of the challenge of implementation during economic hard times; Asian countries were faced with meeting their obligations during the Asian financial crisis. The confluence of trade liberalization and economic recession could be devastating to the fragile economies of SLDCs. However, evidence shows that smaller countries whose economies are linked to larger ones tend to see their growth rates converge upward, i.e., smaller countries tend to benefit from increased linkages.

In order to undercut some of the criticisms that trade liberalization is particularly harmful to developing countries, trade liberalization could be negotiated in stages to be automatically triggered when certain conditions are met. Thus trade liberalization would take place as scheduled when economic growth was above certain targets for SLDCs and/or when levels of foreign investment are sufficiently high.

A second solution, which is not new but could be bolstered, is to provide more trade-related assistance for countries to adjust to new market-opening commitments. Developed countries and regional organizations should offer targeted assistance to sectors that will face adjustment when competition increases in SLDCs. This will also help these countries get buy-in from their governments on the benefits of opening their markets.