



GALT Update

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Over the last few decades, there have been a number of multilateral agreements on environment and trade matters. The working of these agreements and the way they are, in fact, operationalized determines their outcomes and the distribution of costs and benefits. How are the rules of the game in such institutional arrangements framed? Who frames them? Who benefits from them? How do the rules play out across groups and interests? What opportunities and barriers do they create for developing countries? How are trade and environment issues interlinked? These are some of the questions that the GALT (Global Agreements, Legislation, and Trade) Knowledge Area of TERI is engaged in. It seeks to examine and understand how institutional arrangements, in a globalized world, in the area of trade and environment work for developing countries and the needs of the poor. The Area is also engaged in assessing and building the capabilities of different groups and sectors within India and the SAARC (South Asian Association for Regional Cooperation) nations to avail opportunities and to cope with risks that global trade and environmental agreements may create. >>

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This first issue of GALT's newsletter reflects this engagement with institutional arrangements in global trade. It comes at an appropriate time, when both developing and least developed countries, are concerned that the Doha Development Round of trade talks are currently suspended because of an impasse between the three main parties – EU, US, and the developing countries, especially on the issue of agricultural and industrial tariffs. While the trade-related development concerns of developing countries were to take centre stage in this new round, there is a strong feeling among developing countries that their concerns are being repeatedly sidelined, and that a deal at this stage with the current mindset of the developed countries will only have 'destabilizing' and 'de-industrializing' impacts on developing countries.

This issue of GALT investigates why the multilateral trading system finds itself at crossroads, why more and more countries are moving towards regional trade agreements, and what the stakes are for different groups in whether multilateralism succeeds or not. Furthermore, it investigates the compatibility of WTO rules with energy-related issues and proposes ways in which these rules could be applied to the issue of the 'Asian Premium' in international oil pricing. It assesses the role of EU's Generalized System of Preferences in directing the structure and flow of textiles trade and how it has affected India's market access to the EU textiles and clothing market. Finally, it identifies, through an analysis of some of the disputes adjudicated by the dispute settlement body of the WTO, the scope that these interpretations provide for the inclusion of the precautionary principle within specific agreements under the WTO.

We hope you find this issue of GALT interesting.

Ligia Noronha, TERI, New Delhi

Multilateral trade regime at crossroads

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The Doha Round of trade negotiations has been suspended after talks among six major members broke down in Geneva on 23 July 2006. Currently, no official date has been set for the re-opening of negotiations. Some reports indicate that it may resume after the US Congressional elections in November. Others are more skeptical and believe that progress is unlikely before the presidential election in US, slated for 2009. Even taking the optimistic scenario that the trade talks will be re-opened in November, it is now certain that the Doha Round of negotiations will drag on for much longer than initially expected.

A timetable published during the Hong Kong Ministerial Meet of WTO (World Trade Organization) stipulated that by 30 June 2006, WTO member-countries should frame the 'modalities' of multilateral trade rules in agriculture and NAMA (Non-Agricultural Market Access) so that the Doha Round of trade talks can be concluded by the end of 2006. In WTO jargon, a 'modality' is the blueprint of a WTO agreement and is considered to be the most important milestone for the whole negotiating process. However, because of the breakdown in negotiations, WTO member-countries have failed to arrive at the modalities within the given deadline. Wide divergences in country positions on agriculture and industrial goods have resulted in the collapse of negotiations. This failure has once again highlighted that all is not well with the Doha Round. All the deadlines set during the Doha Ministerial Declaration have expired. This string of failures has brought into question the future of multilateral trade negotiations.

WTO Director General, Mr Pascal Lamy, has termed the present impasse as a 'crisis' of the multilateral trading system. He says:

We are now in a crisis. We are far from the necessary convergence to be able to establish modalities in agriculture and NAMA, despite all the hard work put in by everyone.

The root cause of the breakdown of trade negotiations is the wide gap between the negotiating positions of

developed and developing countries on a number of important issues, particularly agriculture. On one hand, there are a handful of developed countries, which are pushing for increased market access liberalization for agriculture and industrial goods but are refusing to impose disciplines on their own domestic farm subsidies. On the other hand, there are countries, mostly developing countries, which are reluctant to make major market access commitments unless the trade distortive farm policy measures are eliminated in developed countries. This has created a virtual deadlock in the negotiations where neither of the opposing groups is ready to make any concessions.

The situation has been further complicated by a shift in the power balance among the WTO member-countries in the negotiations. This shift is evident if one compares the dynamics of the Uruguay Round with the Doha Round of trade talks. In the Uruguay Round, most developing countries took a much less proactive role in the negotiations and the bulk of negotiations was done among the Quad countries (Canada, EU, Japan, and US). However, in the Doha Round, the developing countries have emerged as a counterbalance to the traditional big players.

The assertiveness and involvement of the developing countries stems from two sources. First, in most developing countries, the present level of awareness about WTO and multilateral negotiations is much higher than it was during the Uruguay Round. As a result, most of these countries are finding it politically difficult to sign an agreement, which does not take into account their domestic concerns. Secondly, most of the promises made during the Uruguay Round, about the possible benefits of the WTO agreement, never materialized. The implementation experience of the Uruguay Round also exposed the partial nature of multilateral trade agreements, where developed countries managed to corner most of the benefits from trade openings. Increased awareness about trade talks, coupled with the apprehension about the fairness of the multilateral system, has made developing

countries extremely wary about signing any trade deals, where its costs and benefits are not clearly understood.

In retrospect, the Uruguay Round Agreement led to the expectation that more effective integration of some key sectors in the multilateral trading system would improve economic development in developing countries. There were three main reasons fuelling this optimism. The most important reason was the inclusion of agriculture in the GATT (General Agreement on Tariffs and Trade)/WTO rules. In the Uruguay Round, it was the first time that agriculture was brought under the effective purview of a multilateral trading system. Although agriculture was included in the original 1947 GATT agreement, too many exemptions were allowed to make its inclusion operationally effective. It was believed, at that time, that new WTO rules would bring about a structural change in global agricultural trade, to the benefit of more efficient agricultural producers. As most developing countries are low cost producers of agricultural goods, it was expected that they would significantly benefit from a more open and less distorted global agricultural trade regime.

Another factor fuelling this optimism was that prior to WTO, market access for textile products in developed countries was constrained by the extremely restrictive MFA (Multi-Fibre Agreement), which allowed developed countries to selectively impose quantitative restrictions on the import of textiles and clothing from developing countries. As a result of MFA, the export potential of textile-exporting developing countries was severely restricted. WTO's ATC (Agreement on Textiles and Clothing) intended to phase out this agreement by 2005 and integrate textiles and clothing within the general WTO rules that govern trade in manufacturing goods. As developing countries are major exporters of textiles and clothing, there was an expectation that the removal of quotas would allow these countries to increase their export of textiles and clothing.

The third aspect of WTO, which encouraged developing countries, was the attempted liberalization of trade in services. Traditionally trade in services was under very high levels of protection and was kept out of any multilateral trading system. GATS (General Agreement in Trade in Services) was considered to be an initial step towards the eventual liberalization of trade in services. It was supposed to open up a huge market for developing countries. An estimate by a World Bank report suggests that services trade liberalization has the potential to generate as much as 6 trillion dollars

in additional income in the developing world by 2015, four times the gains that would come from trade in goods liberalization (World Bank 2001). As GATS covers a broad range of services like tourism, education, consultancy, and manpower export, India, which has an abundant supply of skilled and unskilled labour, would benefit from such an agreement.

In exchange for the promise of liberalization in these three key areas, developing countries had to give at least two crucial concessions to developed countries. First, they had to accept the WTO TRIPS (Trade Related Intellectual Property Rights) agreement, which proposed to impose stricter patent laws globally. Second, they also had to remove all non-tariff barriers on industrial and agricultural goods as well as reduce tariff barriers on these products substantially. It was feared that these two agreements would negatively impact the process of industrialization in developing countries. However, it was projected that developing countries would be net gainers as the benefits accruing to them from the liberalization of the three key sectors like agriculture, textiles, and services were likely to more than offset the expected losses from the other two areas.

However, after 10 years of implementing WTO rules, most expectations remain unfulfilled. Developed countries continued to subsidize their farm sector and effective market access in agriculture was thwarted using various tariff and non-tariff barriers. Similarly, in textiles and clothing, most of the quota phase out was back-loaded, which restricted the market access of developing countries. In services, liberalization was limited and developing countries benefited in only a handful of sectors. On the other hand, tariff liberalization and removal of non-tariff barriers exposed the domestic economies of many developing countries to the forces of international trade. In some instances, like in the Sub-Saharan African countries, this has adversely affected overall economic development.

In the Doha Ministerial Meet of WTO, these problems were acknowledged. The Ministerial Declaration launching the Doha Round mentioned that economic development would be given priority over trade liberalization. It was also decided that the implementation-related problems of the Uruguay Round would be taken care of. However, since then, the progress of the trade negotiation has been very sluggish. The negotiating positions of some developed countries have been extremely rigid and, in certain

cases, almost unreasonable. This reveals a disinterest on the part of these countries with regard to addressing the real issues. Instead, such countries come across as singularly keen on acquiring increased market access in developing and least developed countries. This made the developing countries apprehensive and has slowed down the pace of negotiation. As a result, almost all the deadlines set by the Doha Development Agenda have been missed. The initial deadline for establishing the modalities for agricultural and non-agricultural goods was 31 May 2003 and 1 January 2005 was targeted for achieving an overall outcome. However, till date, even the modalities for agriculture and NAMA have yet to be finalized. The gaps between the stances of different countries remain as wide as ever. A further point of concern is that should negotiations not be wrapped up by 2006, then it will be difficult to reach an agreement before 2009. This is because some of the key WTO Members will be going for elections in 2007 and 2008 and the perception is that it will be difficult for them to sign such an important trade agreement during that period.

This delay may just compromise the future of multilateral trade negotiation. During the last few years, dissatisfaction with the multilateral trading system has fuelled the growth of RTAs (Regional Trading Agreements) among countries. The failure of the Seattle and Cancun Ministerial triggered a surge in the number of RTAs. *The Economist* suggests that these failures have highlighted the inherent problems of the multilateral

trading system and are likely to push many countries into diverting their negotiating energies into RTAs. A large number of announcements about formation of new trading blocks since 2003–05 corroborate this argument. RTAs are now threatening to emerge as an alternative to the multilateral trading system. The recent breakdown of the trade talks will fuel such initiatives and prompt countries to look to regional groupings to increase their market size and enhance regional cooperation for economic and strategic reasons.

The uncertainties associated with the Doha Round of negotiations have brought the multilateral trade regime at a crossroads. The progress of negotiations in the next few years will decide whether the world trade regime will continue under the multilateral umbrella or will get fragmented into a few major trade blocks. For developing countries, the choice remains unclear. The multilateral system suffers from power imbalances among countries but the problems associated with unequal power structure and exploitation of smaller members by a bigger economic power can be more acute in a regional trade block. Also, it is always possible that if the world is divided in a few mega trade blocks, then the weakest countries will be marginalized.

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Revisiting gains from the Doha Round

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Introduction

Gains from free trade were postulated by Paul Samuelson in his classic article, more than four decades back, as

Restricted trade is better than no trade, free trade is better than restricted trade.

This theorem holds true under strict neo-classical assumptions. The theorem is also valid under a unilateral liberalization process. Viewed in this context, provided one adheres to as esoteric a framework as neo-classical economics for intelligent policy making, there is really no need for WTO- (World Trade Organization) mandated multilateral trade

liberalization because governments, in their self-interest, will liberalize the trade of both, goods and services, without seeking reciprocity.

However, the real world is far removed from the textbook artifact of neo-classical economics. Politics does play an important role in forming ideology. Contrary to neo-classical assumptions, sectional interests will have to be accommodated in a democratic policy-making process, provided there is proper articulation, backed by vote-bank power. Multilateral institutions, such as the World Bank or IMF (International Monetary Fund), have their own world-views, which may not necessarily be consistent with national understanding of their personal and global welfare. Political compulsions will not allow unilateral liberalization and, therefore, quid pro quos must not only be economically justifiable, but also equitable.

The most basic argument in favour of the Doha Round is the estimated welfare gains arising out of trade liberalization, including removal of/reduction in agricultural production subsidies. Earlier studies by World Bank have shown large gains, projecting a total welfare gain of 832 billion dollars, of which 539 billion dollars would be appropriated by developing countries. Most importantly, it has the potential of lifting 144 million people above the poverty line, defined as two dollars a day. This was the fairly promising scenario presented before the Cancun Ministerial.

Since then, there has been a drastic change in the estimated gains. New modeling results of the World Bank just have brought down the estimates, due to both, a change in the baseline data as well as more realistic assumptions (van der Mensbrugge and Beghin 2005; Anderson, William, and van der Mensbrugge 2006).

Global welfare gains are now estimated at the modest figure of 287 billion dollars. Developing countries are expected to gain only 90 billion dollars – down from 539 billion dollars, estimated earlier. Studies indicate that even these estimates may be highly optimistic. Assuming partial trade liberalization, as expected in Hong Kong (likely Doha outcome), developing countries are expected to gain 6.7 billion dollars only.

The Carnegie model for the estimation of trade liberalization

An excellent study has been brought out by CEIP (The Carnegie Endowment For International Peace), authorized by Sandra Polaski, which deserves more attention, especially in India, than it has been receiving.¹ In comparison with other models for the estimation of trade liberalization, the Carnegie model is more realistic, especially from the perspective of a developing country. In contrast to the normal assumption that the labour market is fully employed, an assumption wholly unrealistic for developing countries, the Carnegie model incorporates actual unemployment rates. Furthermore, the model treats the agricultural labour market as being different from the unskilled urban labour market. One Carnegie model scenario was constructed, after the Hong Kong meeting, to simulate agreements reached in the Ministerial. The same level of tariff cuts were applied to both, the agricultural and manufacturing sector. The reductions were set at levels, which are close to the tariff cuts proposed by members in their respective submissions to WTO. The estimates are tabulated along with the World Bank recent results in Table 1.

Table 1 Assessing gains from Doha

Welfare gains from partial trade liberalization, two models (billion dollars in 2001)

	World Bank Doha Scenario			CEIP Hong Kong Scenario		
	Manufacturing	Agriculture	Total	Manufacturing	Agriculture	Total
High-income countries	13.6	18.1	31.7	16.4	5.5	21.9
Developing countries	7.1	-0.4	6.7	21.7	-0.06	21.64
Brazil	0.3	1.1	1.4	0.8	0.3	1.1
India	2.0	0.2	2.2	2.3	-0.04	2.26
World	20.7	17.7	38.4	38.1	5.4	43.5

¹ Sandra Polaski, *Winners and Losers: Impact of the Doha Round on Developing Countries*.

Results of both the studies reveal that, under realistic assumptions, most developing countries do not have much to gain from the Doha Round of trade liberalization. The Carnegie model shows that the distribution of the modest aggregate gains between the developed and developing countries is on a 60:40 basis, which is quite even. However, intra-developing and LDC (least developed countries) disparities are too high. As a result, a disproportionate amount of the gains will accrue to China, followed by South East Asia, and South Asia while LDCs stand to lose.

Another, more important finding of the study is that very few developing countries stand to gain from agricultural liberalization. Argentina, Brazil, and Thailand are the major gainers. India is a marginal loser. On the other hand, the liberalization of manufacturing trade brings substantial income benefits to most developing countries.

Like most other studies, the results of the Carnegie model are also approximations. However, these approximations are more realistic because the model specifications are more precise and the assumptions correspond to the current level of expectations from the Doha negotiations. Moreover, these are also broadly consistent with the revised World Bank results.

Policy conclusions

Given that the extent of possible gains for majority of the developing countries and the LDC are decidedly modest, should there be concerns regarding the success of the Doha Round? The answer should be in the affirmative for the following reasons.

- There is hardly any doubt that the Doha Round, even if it does conclude with a minimum liberalization, will be anything but a ‘development round’. However, there would be benefits in other spheres.

- If the Doha Round fails, it will signify an erosion of the multilateralism in world trade negotiations. Already bilateral and plurilateral approaches to trade liberalization dominate the current negotiating scenario. Failure of the Doha Round would only serve to strengthen this trend. Multilateralism remains a developing country’s best defense against unilateralism by developed countries.
- The world economic governance structure, which consists of the World Bank, IMF, and WTO, needs to be strengthened in the interests of all. Doha Round, if concluded successfully, will improve the credibility of WTO as an institution. Efforts must be made to make the workings of WTO more democratic, transparent, and efficient.
- Finally, all the modeling exercises leave out the services sector where most potential gains for developing countries are expected to come from, provided a critical mass of proposals get generated. As a result of preoccupations with agriculture and Non-Agricultural Market Access, services negotiations have been placed on a back burner, a situation that needs to be corrected.

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Rules on energy trade and WTO compliance

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Introduction

Petroleum is a crucial commodity of international trade in terms of volume and value. The fluctuation in oil prices in the recent past has drawn attention to the risks of unexpected mismatches between oil demand and supply. There are also obvious national security considerations associated with this for energy exporting and importing countries. Hence the entire international community depends, to a large extent, on the availability and affordability of petroleum products in the international marketplace.

The role of the multilateral trading system on international trade in petroleum products has not always been clear. Due to the strategic importance of petroleum in the world economy, it has often been treated in a largely political context and therefore outside the GATT (General Agreement on Tariffs and Trade) system of multilateral trade rules. However, there is no GATT/WTO (World Trade Organization) provision, which excludes petroleum trade from its mandate. Until the eighties, most of the developing country exporters of petroleum (with the exception of Gabon, Indonesia, Kuwait, and Nigeria) were not contracting parties to GATT. The general attitude of these countries was that the benefits from GATT membership were minimal as these countries traded in a single commodity, where market access was not an issue, while they could lose much more by adhering to the GATT rules on their import regimes in general. However, since the Uruguay Round, a number of OPEC (Organization of the Petroleum Exporting Countries) and other petroleum exporting countries (such as Oman, Sudan, Azerbaijan, Kazakhstan, Iran, Iraq, Mexico, and Venezuela) have either become members of the WTO or are in the process of accession. According to WTO, the share of fuels being traded in

total merchandise increased from about 10.2% in 2000 to 11.1% in 2004 (WTO), recording an increase of almost 9%. Currently, with Russia's accession process and Saudi Arabia becoming a full member of the WTO, the energy pricing issue has come to the fore of the policy debate in terms of its consistency with WTO rules.

This paper discusses the rules of energy trade in WTO, addresses the issue of energy pricing policies implemented by petroleum exporting countries (essentially Russia and OPEC), and analyses their compatibility with existing WTO rules.

WTO rules regarding energy trade

The initial major difficulty in identifying the energy sector as a composite entity lay in the fact that no clear distinction was made between energy goods and services¹. The Secretariat noted that oil and solid fuels, which can be easily stored and traded across borders, can fall under the goods category. However, the case of gas and electricity seems more complicated due to storage, transportation, and distribution difficulties. Majority of the global energy services were not covered by specific commitments under GATS (General Agreement on Trade in Services). However, currently, energy services are included in the new services negotiations, which commenced in January 2000. Now the commitments in energy-related services exist only for a few WTO members; for pipeline distribution of fuels (a sub-sector of transportation services), services incidental to energy distribution, and services incidental to mining (sub-sector of other business services).

The issue of identification and thus the definition of the sector quite obviously represents the first,

¹ S/C/W/52, 9 September 1998.

immediate, and most important issue, which needs to be deliberated. This is a problematic issue since, with the exception of a few countries, energy sectors in most countries are largely dominated by state enterprises that are vertically integrated. The vertically structured nature of this sector, in most countries, makes it inherently difficult to visualize a differentiated energy 'services' sector. For instance, the case of electricity is complicated by the fact that it cannot be stored and needs to be transmitted simultaneously via distribution grids. This constitutes one of the important reasons for the exclusion of electricity as a commodity under GATT². However, there seems to be a general understanding that the production of primary and secondary electricity does not constitute a service either. Therefore, electricity falls outside jurisdiction of GATS³, but would fall under GATT. In the case of energy goods, countries (essentially exporter countries) have in the past relied on general exceptions under Article XX (g)⁴ and the national security exception⁵. Trade in energy goods has generally been subject to bilateral arrangements between exporter and importer countries, with the role of OPEC being the most prominent amongst them. In fact with the international energy market resembling a Hobbesian *state of nature*, there exist urgent reasons to structure international trade in energy within the framework of WTO multilateral rules.

The present scenario is that energy does not feature as a composite sector in WTO, with different parts of it classified under different sectors. However, the important question that arises is whether energy should be dealt as a composite sector or a diversified one. It must be mentioned that there have been previous instances of developing sector-specific disciplines

within the WTO⁶. Thus given the complicated nature of the sector in terms of its vertical integration, public service nature, and physical characteristics, there exists a strong case for developing a sector-specific discipline for trade liberalization in the energy sector. In addition, negotiations at CTSSS (Council for Trade in Services Special Sessions) have largely focused on establishing a case for the gains to be made for the liberalization of the energy services sector. US, for instance, has focused on increased competition leading to a more economically efficient sector, driven by customer demands rather than government planning⁷. While most countries have underlined the role of regulation, they acknowledge the importance of liberalizing the energy sector. For instance, Canada⁸, EC⁹, and US, in their submissions, have unequivocally supported the doctrine of sovereignty over natural resources to assuage the doubts that oil- or gas-rich developing countries may have regarding liberalization and its implications for their territorial control over natural resources so as not to equate deregulation with liberalization.

In this context, it is important to mention that the issue of sovereign control over natural resources of the resource-rich economies has raised a serious concern in terms of securing long-term, stable supply for energy-dependent economies at affordable and competitive prices. Hence, the importance of the issue of energy pricing is undeniable. In the next two sections, we shall discuss the energy pricing policies of Russia and OPEC and analyse them within the context of WTO.

Energy pricing

A major policy issue in Russia's accession process in the WTO is that of 'dual pricing' or two-tier pricing in

² With reference to Article XX (g) of GATT: the Drafting Committee Report noted *as it seemed to be generally accepted that electric power should not be classified as a commodity, two delegates did not find it necessary to reserve the right of their countries to prohibit the export of electric power.* (GATT 1995).

³ Energy Services, Background Note by the Secretariat, WTO 1998

⁴ Article XX(g) of GATT 1947 states *Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.*

⁵ Article XXI lays down a list of security exceptions (such as information disclosure of the nature of security interest, arms, trafficking, nuclear materials) stating that nothing shall be construed to impede a country from undertaking such security related measures or prevent it from protecting its national interest.

⁶ Telecommunication being one – though it is essentially a plurilateral agreement. Recently the Para. 31 (iii) negotiations under the CTESS, have also considered proposals for developing a sector specific discipline for the environmental goods and services sector.

⁷ S/CSS/W/24, 18 December 2000.

⁸ S/CSS/W/58, 14 March 2001.

⁹ S/CSS/W/60, 23 March 2001.

the energy sector, whereby the government keeps domestic fuel prices lower than export prices. Both, EU and US claim that the Russian state controls the price of energy for domestic consumption causing significant trade distortions. Lower prices in the domestic market lead to sizeable differences between the prices paid by Russian companies and prices paid by foreign companies, for the same goods/service. This price differential is perceived, by some WTO members, as constituting a *de facto* subsidy to the energy intensive industries, since the industrial producers do not have to pay the full market price for their energy inputs. EU and US have pointed out that the gap between the price of natural gas, internationally, and the Russian domestic price has been as large as six to one, for electricity, five to one, and for oil, four to one (Cooper 2006). EU maintains that profitable supplies to Europe are used to cross-subsidize domestic supplies at lower prices. US has therefore suggested that the Negotiating Group on Subsidies and Countervailing Measures should review the issue of dual pricing under the broader context of subsidies (Selianova 2004). Russia's trading partners have put forward two major arguments in insisting that Russia's energy policy is inconsistent with WTO. Firstly, they maintain that dual pricing is an actionable subsidy provided to the Russian downstream industry and secondly that the pricing policy is inconsistent with GATT Article XVII for state trading enterprises. The demand to eliminate dual pricing is directed primarily towards gas tariffs, as these tariffs are imposed by the government, which is one of the major shareholders in Gazprom (the natural monopoly dominating the Russian gas market).

However, Russia considers this to be an unreasonable demand. The Russian government and Russian delegates to the WTO negotiations have strongly argued that Russian energy prices are not an actionable subsidy under WTO rules because they are available to all industries and are not specific to any enterprise, industry, or region. They assert, furthermore, that Russia's domestic energy prices reflect its comparative advantage in energy production.

Another issue that comes up in the context of energy pricing is AP (Asian Premium). For years, Asia has been fraught with the premium charged on oil imports from the Gulf, while US and Europe enjoy discounts. Middle East crude oil prices for Asian delivery have averaged at 1–1.50 dollars per barrel more than those

for Europe and US since 1991 (Ogawa 2004). There are reasons why AP was created. According to Parsons and Brown (2003) . . . *Asian countries generally pay more, f.o.b., than Europe or the United States for the same quality oil leaving from the same Middle Eastern port.* Asia is heavily dependent on Middle Eastern oil, while other regions and countries like Europe and US have other competitive markets in Latin American countries like Venezuela and Mexico. For Asia, dependence on the OPEC countries is essential for reasons of geographical proximity. As a result, even without state intervention, there is the potential for gaps in crude oil prices across markets. This price gap is known as AP. Asian countries, Japan in particular, began to realize that the premium hampered their economic growth and reduced their competitiveness, globally. In a recent study, the World Bank (2006) estimates that in developing countries, while GDP (Gross Domestic Product) growth remains robust, higher oil prices have sharply slowed real income growth among oil importers from 6.4% to 3.7%, from 2004 to the present day. Looking forward, continued high oil prices, coupled with inflationary pressures, are expected to restrain growth in most developing countries over the next two years. Hence for Asia (essentially developing Asia), the issue of high oil prices is a matter of utmost concern, given the fact that imports are increasing exponentially with high rates of growth, and that Asia is tied to the Gulf and cannot presently diversify its crude sources.

Though IEEJ (Institute of Energy Economics), in Japan, and other, similar bodies in northeast Asia have been criticizing AP and want it to be resolved, they are cautious and pragmatic in doing so. The issue of AP has not been raised yet in the multilateral trade forum, primarily because there is an absence of clear cut rules on international trade in petroleum products and also because the major trading countries, such as Europe and US are beneficiaries of this.

However, since the last year, refiners in China, India, Japan, and South Korea, have paid less for Saudi and other Middle East crude than their counterparts in US or Europe. Scarcity of supply from the competitive markets other than the Middle East, has wiped out this premium. Now, for the first time probably, the Saudi Arabian light crude has been as much as three dollars cheaper for the Asian lifters than for refiners in Europe or US¹⁰. The important point to note here is that though today we can say that AP no longer exists,

¹⁰ *The Financial Express*. 2005. **Asian oil importers may have to pay premium this time.**

there is a possibility of its re-emergence, in case EU and US are able to find new sources to procure oil. Hence if AP arises in the near future, the issue should at once be treated under the WTO discriminatory pricing policy, and seek to get some medium to long-term solutions to the problem.

Energy pricing issues and the WTO

The issue of dual pricing has been earlier addressed in the GATT Ministerial meeting of 1982 and during the Uruguay Round. However, not much headway could be made because of opposition from developing countries. This opposition stemmed from the fact that any efforts to curb dual pricing would *prima facie* violate the international legal principle of a state's sovereign right to its natural resources. In this context, it should be mentioned that the dual pricing issue in the context of WTO only assumes relevance in the case of the role of the state (through its ownership of the state utilities) in pricing the crude oil at domestic markets at a much lower rate than to the international consumers.

The dual pricing policy of Russia *vis-à-vis* natural goods could possibly be defended under two broad contentions. Firstly, dual pricing would fall under the disciplines of subsidies in WTO and made actionable if the policy is exclusive in nature – meaning that it is directed towards a specific enterprise, region, or industry. Dual pricing would therefore only become actionable if it results in the creation of an export advantage for domestic enterprises, which is not the case in Russia. Secondly, there are also claims that the energy pricing policy is inconsistent with Article XVII dealing with STEs (State Trading Enterprises). Article XVII focuses on the behaviour of STEs and aims to avoid state control over trade that would affect market access commitments. However, price discrepancies in Russia are the result of governmental regulation suppressing domestic energy prices¹¹. Hence, it may be argued that Article XVII (a), which addresses the practice of STEs, is not relevant here. On the other hand, there is a strong logic that since Gazprom while supplying gas in the domestic market incurs losses, the existing practice cannot be based on sound commercial considerations, as phrased in Article XVII.1 However, this is not a separate obligation.

This interpretation was affirmed in Canada-FIRA (Canada-Administration of the Foreign Investment Review Act), in which the Panel considered that the provision in Article XVII.1 (b) *does not establish a separate general obligation to allow enterprises to act in accordance with commercial considerations, but merely defines the obligations set out in the preceding subparagraph*, which requires that *enterprises act in a manner consistent with the general principles of non-discrimination prescribed in GATT*.¹² Given this interpretation, the issue of whether Gazprom's practice is based on commercial considerations or not becomes relevant only when it is seen to contradict the principle of non-discrimination. It has been widely argued that there are strong indications that Article XVII requires STEs to act in accordance with the MFN (most favoured nation) principle in its sales or purchases but does not require the application of national treatment. Since Russia's energy pricing aims at establishing preferential prices for the domestic market, it cannot be inconsistent with the MFN principle prescribed by Article XVII. Russia's practice can also be defended under the legal argument of the state's sovereign right to its natural resources. The sovereign right of the state to their natural rights have been a controversial subject. In the context of WTO, most developing countries endowed with natural resources (and that being the most important economic commodity) would like to maintain their national policy space in terms of preserving their comparative advantage, which can be reflected through a lower energy price in the domestic market.

The case of AP is certainly different. Preferential price differentiation under AP would violate Article I – the MFN principle. According to the MFN principle; any advantage, favour, privilege, or preference given to one country should be immediately extended to all the other WTO-member countries. One of the exceptions to this principle is that of regional integration (Article XXIV). Thus regional or bilateral trading agreements may qualify to be exception to the application of the MFN Principle¹³. In this context, if the preferential price treatment given to North America or Europe is governed by a bilateral or a regional trading agreement, it may then be a valid exception to the MFN principle. In the case of AP, however, the preferential

¹¹ FEC (Federal Energy Commission) and REC (Regional Energy Commission) are responsible for price regulation for energy products such as gas and electricity in Russia.

¹² Canada-FIRA. 1984. Report of the Panel, 1/5504, adopted 7 February 1984, 30S/140, 163, para 5.16.

¹³ Regional and bilateral trading agreements have to conform to the conditions laid down under Article XXIV of GATT

price given to US and Europe is not under any bilateral or regional trading agreement. The preferential price is directly linked with the North Brent Oil Market and the Western Texas Intermediate – which are the oil markets for Europe and US, respectively. In the case of Saudi Arabia, STEs may be found to be violating core WTO principles. For instance, Saudi Aramco, on behalf of the Saudi government, produces more than 95% of the country's oil. Strictly speaking, Saudi Aramco is not an STE, however, it does have integral links with the Saudi government and is more like a parastatal enterprise. Saudi Aramco, being involved in the exportation of oil at preferential prices to Europe and US, could possibly trigger the violation of WTO's MFN principle.

Conclusion

In conclusion it can be said that the energy sector continues to be largely in uncharted waters under the WTO regime. With more and more energy producing countries aspiring to be WTO members, a strong case can be made for the expansion of trade rules for energy trading. Hence the basic point to be made is that WTO should have clearly defined rules that govern trade in energy. The inclusion of transparent rules is desirable to avoid complexities and enable countries to act accordingly. In this context, it is probably worthwhile to consider developing a sector-specific discipline for the energy sector, which would address the unique characteristics of the sector and devise the best possible methodology for application of the multilateral trade rules to the sector. Such an exercise would also, to a large extent, reduce the fears of developing country exporters who have had a historical reliance on imported energy to fulfill their development needs.

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Precautionary principle in WTO disputes: a case analysis

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Introduction

Recent conclusion of the EC-Biotech case by the Panel again brings to the fore the much deliberated conflict of trade and environment. A crucial element of the debate is the principle of precaution. The precautionary principle, despite being recognized in a number of multilateral legal instruments, remains one of the most complicated concepts at the international level. The EC-Biotech case has been seen as a challenge as well as an opportunity for resolving, to whatever extent possible, the larger question of trade versus environment interests of the WTO (World Trade Organization) members. The controversy remains unresolved, as the panel report is yet to be made public. However, preliminary analysis does not indicate any end to this prolonged debate. Starting from the Rio Declaration, the precautionary principle has been recognized by numerous international legal instruments, directly or indirectly. However, against this large body of legal instruments, WTO seems to position itself at the other extreme that often questions the very rationale of the precautionary principle. This paper examines the status of the principle within the evolving trade-led WTO jurisprudence. We will look into some of the disputes adjudicated by the dispute settlement body of the WTO and focus on the scope that the interpretations provide for the inclusion of the precautionary principle within specific agreements under WTO.

The precautionary principle: within and outside the WTO regime

The precautionary principle can be described as a principle of action on the potential effect of certain activities on the environment, even in the absence of scientific certainty about the nature and extent of such effect. The principle calls for preventive action before the uncertainty is resolved. Recognition of the principle at an international level can be traced back to the 1982

United Nations General Assembly Resolution on the World Charter of Nature. Though it did not incorporate the principle specifically by name, it included two directives that are important constituents of the precautionary principle – (1) activities that are likely to cause irreversible damage to nature shall be avoided and (2) activities that are likely to pose a significant risk to nature shall be preceded by an exhaustive examination, their proponents shall demonstrate that expected benefits outweigh potential damage to nature, and where potential adverse effects are not fully understood, the activities should not proceed. It would be pertinent to note here that the Resolution incorporates both the theories of irreversible damage and scientific uncertainty. Perhaps the most well known international instrument that incorporated this principle is the Rio Declaration. Principle 15 of the Rio Declaration says that in order to protect the environment, the precautionary approach shall be widely applied by states according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation. The principle has also been specifically incorporated in the UN (United Nations) Framework Convention on Climate Change and CBD (Convention on Biological Diversity). Both these instruments are legally binding on the parties to the conventions.

As far as the agreements under WTO are concerned, none of them bear specific mention of the precautionary principle. However, the concern of scientific uncertainty *vis-à-vis* the effect of a particular activity on the environment finds some recognition under the SPS (Sanitary and Phytosanitary Measures) agreement. Article 2 of the Agreement, which confers rights to member countries to take SPS measures for the protection of human, animal, or plant life or health, requires that such measures should be applied only to

the extent necessary and not maintained without sufficient scientific evidence¹. As an exception to this requirement of sufficient scientific evidence, Article 5.7 provides that in cases where relevant scientific evidence is insufficient, a member may provisionally adopt SPS measures on the basis of available pertinent information. Such information is inclusive of information from the relevant international organizations as well as from SPS measures applied by other members. It further requires the members adopting provisional measures to obtain additional information necessary for a more objective assessment of risk and review the SPS measure accordingly within a reasonable period of time. It would be pertinent to mention here that unlike multilateral environmental agreements like CBD, or the Cartagena protocol thereunder that confers right/obligation or provides scope for proactive action *vis-à-vis* the precautionary principle, under WTO the principle finds mention only as an exception. Within the overall objective of trade liberalization, the SPS agreement provides a window for trade restrictive measures with the purpose of protecting human, animal, and plant life or health. Article 5.7 provides an even narrower space to incorporate concerns of insufficient scientific evidence and consequent inability to make an objective assessment of the risk involved with a particular entity in trade. This has implications for the scope of the interpretation that could be conferred to the provision.

WTO disputes and the precautionary principle

The interpretations made to the relevant articles of the SPS agreement by the dispute settlement body provides useful insights into the scope of incorporating environmental issues within WTO's philosophy of trade liberalization. It would be interesting to look at the panel or Appellate Body reports of some of the disputes between WTO members to highlight specific aspects of the precautionary principle, as incorporated in the SPS agreement. In the interest of brevity, we will restrict ourselves only to the interpretations and will not go into the details of the facts involved in the disputes.

As mentioned earlier, Article 5.7 of the SPS agreement provides the scope of incorporating the precautionary principle in the form of adoption of provisional SPS measures, even without sufficient scientific evidence. However Article 5.7 is only an exception to Article 2.2 and consequently 'insufficiency of relevant scientific evidence' under Article 5.7 is intertwined with the question of whether the SPS measure is maintained without 'sufficient scientific evidence'. The panel in the Japan-Apple² case referred to the following aspects of 'sufficient scientific evidence' that need to be taken into consideration.

- 1 The very notion of 'scientific evidence' seems to exclude elements of information that cannot be considered as 'evidence'. The same notion also seems to exclude any evidence that is not 'scientific'.
- 2 The term 'sufficient' seems to address not only the quantity and quality of the evidence as such, but also the 'causal link' between the phytosanitary measure at issue and the scientific evidence establishing a phytosanitary risk and justifying the measure.

The Appellate Body in the *Japan-Agricultural Products II*³ case said that the obligation in Article 2.2 requires that there be a rational or objective relationship between the SPS measure and the scientific evidence⁴. It also noted that Article 5.7 sets out four requirements, which have to be met in order for a measure to be justified as a provisional measure. These requirements, cumulative in nature, are as follows.

- § The measure is imposed in respect of a situation where 'relevant scientific evidence is insufficient'
- § The measure is adopted on the basis of 'available pertinent information'
- § 'Seek[s] to obtain the additional information necessary for a more objective assessment of risk'
- § 'Review[s] the ... measure accordingly within a reasonable period of time'

The Appellate Body added, 'Whenever one of these four requirements is not met, the measure at issue is inconsistent with Article 5.7'.⁵

Referring to the overall theme of 'risk assessment' under Article 5 of the SPS agreement, the Appellate Body in the Japan-Apple case interpreted Article 5.7 as

¹ Article 2.2

² WTO document no. DS 245

³ WTO document no. DS 76

⁴ Appellate Body report in *Japan - measures affecting agricultural products*, para 84.

⁵ Appellate Body report in *Japan - Agricultural Products II*, para. 89.

‘...“relevant scientific evidence” will be “insufficient” within the meaning of Article 5.7 if the body of available scientific evidence does not allow, in quantitative or qualitative terms, the performance of an adequate assessment of risks as required under Article 5.1 and as defined in Annex A to the SPS Agreement...’.

Thus the Appellate Body opined that the question, under Article 5.7, is whether the relevant evidence is sufficient to permit an evaluation of the risk that the SPS measure aims to prevent. This is irrespective of whether the relevant evidence is general in nature or about a specific aspect of the risk in question.

Thus, in a dispute regarding the sufficiency of scientific evidence justifying the adoption of an SPS measure by a member, the Panel can proceed to look into the ‘casual link’ between the available scientific evidence and the measure in question and if convinced about the absence of such a link, the Panel can proceed to examine whether the available scientific evidence enables an objective assessment of the risk that the member country envisages. The emphasis on scientific backing to the possibility of a risk is apparent and it is only ‘insufficiency’ rather than ‘uncertainty’ that would render the adoption of a provisional measure compliant to the WTO regime⁶. This emphasis on scientific evidence does seem to contradict the underlying philosophy of the precautionary principle, to acknowledge the limits of scientific predictability.

However, some observations of the Appellate Body in the *Hormones*⁷ case should be noted here⁸. Recognizing that the precautionary principle cannot be grounds for justifying an SPS measure, which is otherwise inconsistent with obligations set out in the agreement. As a result, the Appellate Body opined that the precautionary principle is reflected in Article 5.7 of the SPS agreement. Furthermore, it observed that Article 5.7 does not exhaust the relevance of the precautionary principle in the WTO rules, and referred to the sixth paragraph of the preamble and Article 3.3 of the agreement, which recognizes the right of members to establish their own appropriate level of sanitary protection. According to the Appellate Body, the fact that responsible representative governments

commonly act from the perspective of prudence and precaution in cases of risks of irreversible damage to human health should also be taken into consideration in adjudicating the sufficiency of scientific evidence *vis-à-vis* an SPS measure. At the same time, however, the Appellate Body also pointed out that without a textual directive to that effect, the precautionary principle does not relieve a panel from the duty of applying the normal principles of treaty interpretation in reading the provisions of the SPS agreement. This, in fact, renders the attempt of broadening the ambit of Article 5.7 redundant, since, as explained earlier, the emphasis on scientific evidence is too obvious in the substantive provisions of the SPS agreement to allow any venture to incorporate concerns beyond science.

The analysis however leads us to another window in the form of Article 3.3 wherein the precautionary principle could find a scope of application. The issue found some mention in the *Asbestos*⁹ case, wherein the Appellate Body recognized the right of WTO members to determine the level of protection (of health) that they consider appropriate in a given situation¹⁰. It implies that a member country may choose a level of protection based on considerations of precaution. However, there has to be proportionality between the SPS measure that it adopts and the level of protection that it chooses to achieve. Furthermore, it must be consistent with other conditions of the SPS agreement, particularly the requirements of risk assessment under Article 5. This implies that the requirement of risk assessment still has to be fulfilled and any deviation would require justification on the basis of Article 5.7.

Conclusion

Compared to the objective of trade liberalization that runs through all the instruments under WTO, DSB (Dispute Settlement Body) does not seem to have achieved much success in liberating the interpretations to include concerns other than economic interests. The express reliance on science and predictability, to the non-inclusion of social science in the WTO regime, does not leave much scope to include the uncertainty

⁶ See Appellate Body report in *Japan – Apple case*, para 184.

⁷ DS 48

⁸ Appellate Body report in *EC – Hormones case*, para 124

⁹ DS 135

¹⁰ Appellate Body report in *Asbestos case*, para 168

involved with science and its consequent socio-political effect on the acceptability of a particular product. This, *prima facie*, runs counter to the precautionary principle's underlying philosophy of acknowledging the fact that scientific knowledge is not free from qualifications. Another important aspect of this non-inclusion of social sciences, is the issue of state sovereignty and government's rights and obligations towards ensuring environmental health and safety for its citizens *vis-à-vis* its obligation of trade liberalization under WTO. For example, in both, the Asbestos case and the EC-Biotech case, the defendant governments' actions were, to an extent, triggered by strong domestic public opinion. However, as the debate on trade versus environment intensifies, these concerns are bound to find reflection in disputes, arguments, and adjudications.

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Textiles and clothing sector under EU-GSP arrangements: implications for India

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The EU-GSP (European Union-generalized system of preference) scheme is very crucial for India's textiles and clothing sector in the post-quota regime, as Europe is India's second largest market for textiles and clothing products. Moreover, there is no similar tariff preference available in US for textiles and clothing products, which is India's largest market for the same. However, sometimes the preferences received by India under the GSP scheme are outstripped by similar preferences received by other competitors from the scheme or any other outside arrangements.

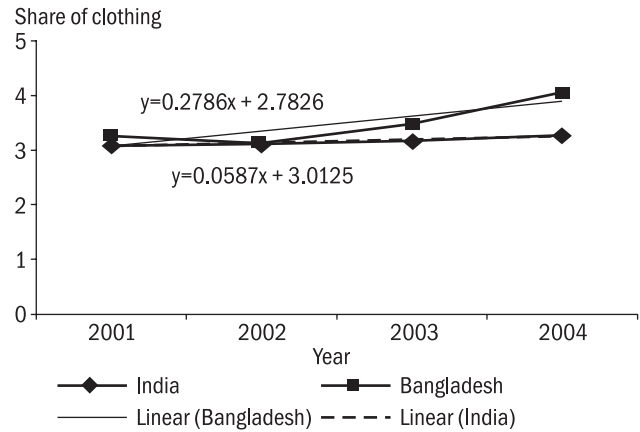
Especially if the preference scheme includes South-Asian textiles and clothing suppliers, who are India's close competitors in the textiles and the clothing market. The purpose of this article is to explain the role EU-GSP has played in deciding the structure and flow of textile trade in the developing world, especially in South Asia and its implications for India's textiles and clothing industry.

EU-GSP is the most widely used scheme available to developing countries, with an import value of about 52 billion euros in 2003 (Aggarwal, 2005). The

preferences were available to all developing countries (countries which are members of UNCTAD [United Nations Conference on Trade and Development] G77 are categorized as developing economies) including China who is not a member of G77. According to a 2002 estimate, China is the biggest beneficiary of the EU-GSP scheme, followed by India. Though both, the Chinese and Indian textiles sector were graduated from the GSP scheme in late 1990, still, China remains the largest importer of textile products to EU whereas India takes the third position, after Turkey (intra-EU trade is ignored for the time being). This implies that China and India have a comparative advantage regarding such products in the EU market, though India is far behind China in terms of volume. Careful analysis reveals that different, special GSP schemes, introduced by EU at different points in time, have helped many supplier countries come into close competition with India in the textiles and the clothing market. Turkey's success in the EU market in textiles and clothing products is an exception in the sense that the country has gained substantially after it had formed a customs union with EU in the late 1990s. As a result, Turkey enjoys duty-free access to the EU market. Textiles and clothing products account for 40% of total Turkish exports to EU. Similarly, EU has bilateral agreements with East European countries, which enabled these countries, especially Romania and Bulgaria, to increase their supply of clothing products to the EU market.

With regards to special arrangements under the EU-GSP scheme, it is important to note that in 2001 and 2002, EU introduced certain special initiatives for a few developing countries and for all LDCs (least developed countries) under the GSP scheme. LDCs were given duty-free and quota-free access for all LDC-originating products with the exception of arms and ammunitions (HS chapter 93) (European Commission 2001 [a]). Almost 80% of EBA (everything but arms) imports to EU are of textiles and clothing products. Bangladesh, which is the biggest beneficiary of the EBA initiative, gained a substantial share in the EU textiles and clothing market since 2001. In clothing products, Bangladesh's share increased from 3.25% to 4.05% in the last four years (2001–04) whereas India's share increased marginally from 3.09% to 3.26% in the same period (Graph 1). Bangladesh has become the fifth largest supplier of clothing products to the EU market in recent years (2003, 2004).

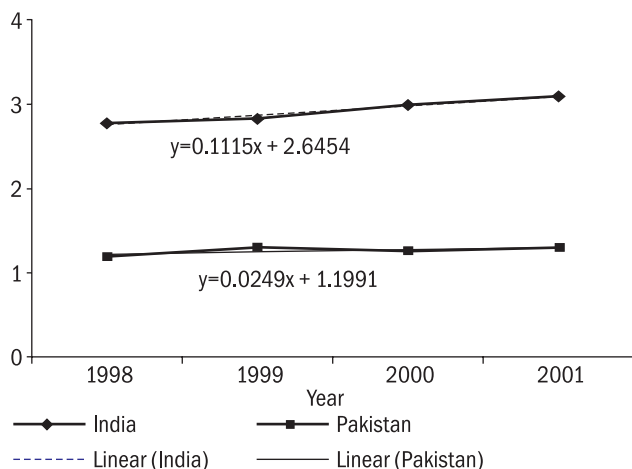
The introduction of the drug regime (European Commission, 2001 [b]) in 2002, triggered a controversy.



Graph 1 Share of clothing import in EU

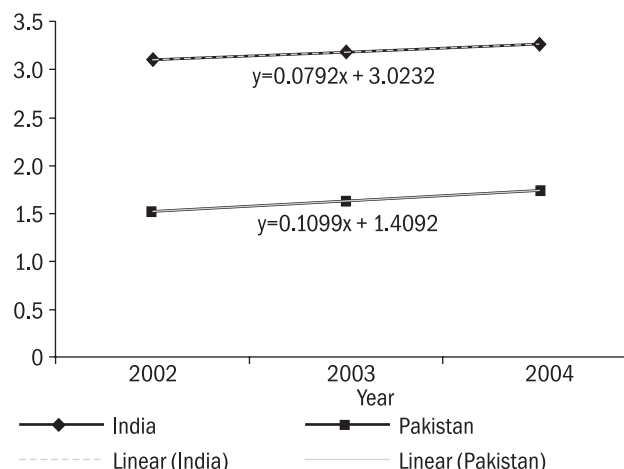
Source EUROSTAT data

Under this regime, the beneficiary countries were given an additional margin of preferences for undertaking programme to combat illegal drug production and trafficking. Pakistan became a beneficiary country of this programme from 1 January 2002 and enjoyed additional preferences in clothing products over India. Since textile products from India and Pakistan graduated from the scheme in the previous GSP regime, textile imports from Pakistan were not entitled to get the additional benefit under the drug regime. Two factors need to be considered here. First of all, a very low percentage of textiles and clothing products (29% in 2001) were subject to binding quotas under MFA (Multi-Fibre Agreement) in which both Pakistan and India compete in the EU market (Martin 2004). So, the major competition between these countries is in the non-quota market, where more tariff preference works as an extra cost advantage for suppliers in question. Even in the quota market, Pakistan had an extra advantage as EU increased the quota for textiles and clothing products by 15% in the aftermath of 9/11. As a result, Pakistan's annual percentage change of clothing exports over the previous years was 7%, 25%, and 20%, respectively, in three consecutive years (2002, 2003, and 2004), whereas the percentage in previous years was negligible. Moreover, the tariff advantage received by Pakistan over India adversely affected India's supply of clothing products in the EU market because both the countries have a similar product range, buyer profile, and also they cater to almost same market segments (Dhar, 2006). It is evident from the following graphs (Graphs 2 and 3) that there is a stark difference in the growth rate of clothing import share by the two countries in pre- and post-drug regime. During 1998–2001, Pakistan's clothing share had increased at a rate



Graph 2 Share of clothing import in EU 1998–2001

Source: EUROSTAT data



Graph 3 Share of clothing import in EU 2002–2004

Source: EUROSTAT data

of just 2%, while India's share was increasing at the rate of 11%. During 2002–04, India's clothing exports increased at the rate of 38% whereas Pakistan's export increased at the very high rate of 53% (WTO International Trade Statistics). However, during the drug regime, Pakistan's clothing import share grew at the rate of 10% whereas it had fallen to 7% in the case of India.

As a result, India initiated a case against EU at DSB (Dispute Settlement Body) of WTO, questioning the compatibility of the drug arrangement with both, GATT Article I as well as 'Enabling Clause' in 2002. The Appellate Body report (WTO 2004) adopted by DSB ruled that in granting differential treatment, donor countries should ensure 'non-discrimination'. In other words, identical treatment should be provided to all countries with similar development, trade, and financial needs.

EU has adopted its new GSP, for the period of 2006–15, in response to the Appellate Body's ruling on the drug arrangement. The initial scheme announced is for two years, starting from 1 January 2006. India remains dissatisfied with the new GSP scheme though it too discontinued the drug regime. The major cause of concern is GSP's new graduation mechanism, which replaced the earlier criteria, combining development index with lion's share or export specialization index by a single criterion. For textiles and clothing products, if the imports of the product group (according to EU customs code) from the beneficiary country exceed 12.5% of total EU imports of same products under GSP, the country will be graduated from the scheme for textiles and clothing products (for other sensitive products, the limit is 15%) So, India's textiles sector is already out of the preference scheme and there is

growing apprehension that the clothing sector will follow suit, as the growth rate of clothing export to EU is very high.

Moreover, EU has also started a new GSP plus scheme for vulnerable economies with regards to their compliance with different international treaties regarding human rights, labour standards, environmental standards, and good governance principles. According to the experts, EU may impose environment and labour standards on small economies through this route. The relationship between trade preference and good governance is also not very clear. Pakistan is now out of the special arrangement but Sri Lanka is one of the beneficiaries of the new scheme. Under the scheme, Sri Lanka will get duty-free access to the EU market in almost all products, including textiles and clothing. Since Sri Lanka is one of India's biggest competitors in the clothing sector, it will help the country to get an edge in the EU market. On the other hand, India can gain from the proposed SRC (Super Regional Cumulation), as it will help the country to acquire intermediate goods from a wider geographical area. A research study conducted by UNCTAD indicates that, through SRC, India will be able to expand its total export to EU, more specifically apparel and other final products. It would also help the country to build a regional production network (textiles committee, 2005).

Apart from their impact on India, EU-GSP special incentives have some negative consequences for South Asian suppliers as well. South Asian countries are primarily export economies and their export basket consists primarily of textiles and clothing items (66.47% for Pakistan, 85.19% for Bangladesh, and 55.67% for Sri Lanka in the year 2003) (Beena, 2006). While these

special schemes, introduced by EU, helped the countries sustain their supply of textiles and clothing products in the world market, even in the post-MFA era, the fact remains that it also increases a country's dependence on such products under the umbrella of preferences. In fact, data shows that the share of textiles and clothing exports to total exports has increased over time, especially in small economies like Bangladesh, Sri Lanka, and Nepal. The new GSP plus scheme, introduced by EU, where Sri Lanka is one of the beneficiaries is one such example. One of the criteria for obtaining preferences under GSP plus is that the five largest sections of GSP-covered imports from a particular country must represent more than 75% of the value of its total GSP-covered imports. So, the scheme encourages countries to have an undiversified export structure. This increasing dependence on the sector may have an adverse impact on economies when the preference will be eroded as a result of the Non-agricultural Market Access negotiation under WTO.

It is evident from the above analysis that India suffered more because of special preferences being provided to rival countries rather than being graduated from the scheme. Since the inception of the new GSP scheme, India has become more concerned about Sri Lanka's inclusion in the GSP plus scheme rather than the possibility of its own graduation from the scheme for clothing products. However, it is important to note that price may not be the only criteria to increase the market share. It is evident from EU import data that not all the countries with zero duty access have gained from the scheme and in fact some of the countries have lost market share in the post-MFA regime. Textiles and clothing trade is becoming more and more complex nowadays. Therefore, integration of value chain, reliability of suppliers, and quality of products may have more of an impact on exports rather than the import duty of a product (Tewari 2005). Moreover, competition can also come from outside of GSP beneficiary countries. As mentioned earlier, countries like Bulgaria, Romania, and Turkey have acquired more market share due to their special trade relationship with EU in recent years. Similarly, there is a threat that newly acceding countries will become the main suppliers of textiles and clothing products to EU-15. The intra-EU trade in textiles and clothing has increased substantially after EU-enlargement occurred in 2004.

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