

Productivity Commission
Submission to DFAT on
Australia's Approach to
Forthcoming Trade
Negotiations

July 2001

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The Productivity Commission

The Productivity Commission, an independent Commonwealth agency, is the Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

Foreword

The Department of Foreign Affairs and Trade (DFAT) has requested public comment on the approach that Australia should take to the Fourth Ministerial Conference of the World Trade Organization (WTO), to be held in November 2001 in Qatar, and any subsequent trade negotiations.

The Productivity Commission and its predecessors have provided information and advice on Australia's trade policies over several decades. The Commission has often addressed trade issues in the context of industry assistance inquiries, such as its 1999 report on 'safeguard' action for pigmeat producers, and its recent review of Australia's general tariff arrangements. Trade issues have also arisen in Commission inquiries into social and environmental issues, such as its inquiries into broadcasting, gambling and the costs and benefits of reducing greenhouse gases.

The Commission also addresses trade matters through its supporting research program. In recent years, for example, it has released a series of studies on the extent and economic impact of trade restrictions in various service industries. And in its most recent Annual Report, the Commission examined issues to do with globalisation, the WTO, and Australia's stake in the multilateral trading system.

In this submission to DFAT, the Commission provides comments on: why and how the Australian government should continue to support trade liberalisation and the WTO system; Australia's main interests in the agenda for a new round of multilateral negotiations; and other trade-related matters where the Commission has undertaken relevant research.

The Commission has not sought to provide a comprehensive or detailed treatment in this submission. Rather, it offers an overview, drawing on a range of more detailed studies by the Commission and others.

Gary Banks
Chairman

23 July 2001

DFAT Request For Public Comment

‘On 3 April, the Minister for Trade, the Hon Mark Vaile MP, announced a process of public consultation to assist the Government in formulating Australia’s approach to forthcoming multilateral trade negotiations in the World Trade Organization.

The Fourth WTO Ministerial Conference will be held in Doha, Qatar from 9-13 November 2001. WTO Ministers will examine the desirability of initiating a new round of multilateral trade negotiations. By prior agreement, negotiations on several WTO agreements, in the areas of agriculture, services and intellectual property are currently underway. In addition, the preparatory process will also examine the desirability of negotiations or further study on other topics. The range of topics is open-ended but, by way of example, there have been calls for work on trade and investment; trade and competition policy; trade and environment; transparency in government procurement; electronic commerce; industrial market access and WTO institutional issues.

Accordingly, DFAT invites public comment on WTO related issues, including the:

- agenda for future multilateral trade negotiations, including the subject matter, content and timetable for negotiations, or other further work in the WTO;
- desirability for Australia’s interests of including in the WTO’s negotiating agenda new issues such as those identified in the paragraph above;
- broader range of issues which Australia might propose for inclusion in the WTO agenda for further work; and
- operation and the effect on Australia’s national interest of existing WTO Agreements.

Written comments on these matters are invited from all interested parties, including members of the public, business groups, non-government organisations and companies. ...The deadline for receipt of submissions is 1 July 2001 [subsequently extended to 1 August 2001]. Supplementary information on this request can be found on the Department’s web site at www.dfat.gov.au.’

(DFAT 2001)

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Abbreviations

ABS	Australian Bureau of Statistics
AFTA	ASEAN Free Trade Agreement
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
ATC	Agreement on Textiles and Clothing
CER	Closer Economic Relations (between Australia and New Zealand)
CRTA	Committee on Regional Trade Agreements
DFAT	Department of Foreign Affairs and Trade
EC	European Commission
EU	European Union
FTAP	Foreign Trade Analysis Project
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
ILO	International Labour Organization
IRA	import risk analysis
MFA	Multifibre Agreement
NAFTA	North American Free Trade Agreement
OECD	Organization for Economic Cooperation and Development
PC	Productivity Commission
RIRDC	Rural Industries Research and Development Corporation
RTA	Regional Trade Agreement
SCM	subsidies and countervailing measures
SPS	sanitary or phytosanitary
TRIMs	Trade-Related Investment Measures
TRIPs	Trade-Related Aspects of Intellectual Property
UNCTAD	United Nations Conference on Trade and Development
US	United States (of America)
VER	voluntary export restraint
WTO	World Trade Organization

Key messages

- A substantial body of research indicates that liberal trade policies facilitate economic growth and rising living standards.
 - Liberal trade policies have been key contributors to development and poverty alleviation. Contrary to common perceptions, these policies do not appear to be exacerbating global inequality and may be reducing it.
 - Domestic liberalisation offers the main benefits, but Australia stands to gain extra benefits if its trading partners further reduce their trade barriers.
- While the WTO system can be improved, it provides a rules-based multilateral framework for trade which has brought widespread benefits.
- The Australian government should continue to support trade liberalisation and increase its efforts to maintain and improve the WTO system.
 - Among other things, Australia should support the establishment of institutional mechanisms in each WTO country to provide information on the domestic costs and benefits of protection.
 - It should also back developing country interests in trade liberalisation by promoting reform in agriculture and services, and through technical and trade facilitation assistance and appropriate governance changes to the WTO.
- Australia, together with its Cairns Group partners, should reject so-called ‘multifunctionality’ arguments for agricultural protection and push for deep cuts to current levels of agricultural support in overseas countries.
- In relation to services, Australia should advocate broad negotiations, the reform of ‘market access’ as well as ‘national treatment’ restrictions, ‘tops down’ reform, and stronger mechanisms in all countries to vet domestic regulation.
- WTO rules governing regional trade agreements (RTAs) should be reviewed to make them more consistent with the spirit of open multilateralism. A fall-back option is to push for a comprehensive review of current RTAs.
- Anti-dumping and other forms of ‘contingent protection’ should be reviewed as part of the forthcoming trade negotiations, but at this stage, there are good reasons not to focus on linkages to environmental and labour standards, changes to the SPS Agreement, or investment rules.

1 Trade liberalisation and the WTO

In its Request for Public Comment, DFAT seeks views on the effects on Australia's interests of the operation of the WTO and the multilateral trading system.

From its inquiry and research work, the Commission has found that domestic trade barriers, while generating benefits for producers in some sectors of Australia, usually create greater costs in other parts of the economy. Trade liberalisation by foreign countries will generally bring benefits for Australia and the world more broadly. The Commission has also found that the rules-based multilateral trading system, while by no means perfect, provides a stable framework within which international trade can flourish.

There have been significant reductions in trade restrictions in industrialised countries, particularly for manufactured goods, since the establishment of the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT), in 1947. Average tariff levels for manufactured goods in industrialised countries have fallen from over 40 percent then to 4 percent today. Successive Australian governments have largely caught up with those international reductions in manufacturing assistance over recent decades, particularly with the program of phased tariff reductions which commenced in 1988. The average effective rate of assistance for manufacturing has fallen from 35 percent in 1970 to 5 percent today (PC 2000a). Assistance to Australian agriculture remains low on average.

In recent years, there has been some revival in protectionist sentiment within Australia. While protectionist pressures have always been evident, recent developments may in part be a more general reaction to adjustment pressures within the economy. They may also reflect frustration over lack of access to foreign agricultural markets and perceptions about some specific WTO findings 'against' Australia. These types of pressures have also been reflected in some recent official statements on trade issues.

Concerns have also been voiced recently about adverse social, cultural, environmental and other developments that are attributed to liberal trade policies and the influence of the WTO. The debate about the WTO is not always conducted rigorously or constructively. However, the debate does raise questions which have to be considered in establishing a new round of multilateral trade negotiations.

In view of these developments, in this section the Commission briefly revisits the case for trade liberalisation and the WTO system.

1.1 The benefits of trade and its liberalisation

Economic impacts

Liberal trade policies offer economic benefits for all countries. Trading allows countries to specialise production in their areas of relative strength, and exchange this output for products which other countries can supply at lower cost. It enables access to cheaper, better and different goods and services. Access to foreign products and skills helps diffuse innovations and new production technologies. Liberal trade policies increase effective market size, which allows producers to reap 'economies of scale'. And openness to trade provides a source of additional competition to keep local prices in check and domestic producers 'on their toes'. All these forces work to promote efficient resource use which facilitates economic growth, high incomes and rising living standards.

A substantial body of empirical evidence supports this view.

- First, a series of in-depth country case studies sponsored by the World Bank and others from the late 1960s to the early 1980s found that, after accounting for numerous country-specific factors, 'trade does seem to create, even sustain, higher growth' (Srinivasan and Bhagwati 2001).
- Second, several studies have used cross-country regression analysis to examine the link between countries' economic growth and indicators of their degree of openness to trade. These studies generally support the view that greater openness to trade is associated with higher economic growth.¹
- Third, a more recent study by World Bank researchers (Dollar and Kraay 2001) supplemented case studies of post-1980 globalising nations with cross-country regression analyses. Drawing on data for around one hundred countries, the study found a strong positive effect of trade on growth.
- Fourth, a recent WTO-commissioned study (Ben-David and Winters 2000), into the effects of trade on income disparity and poverty, combined case studies of regional trade integration with comparisons of income convergence between trading partners and non-trading partners, and time-series analyses of individual country growth paths. The study concluded:

¹ In a review of this literature, Rodrik and Rodriguez (1999) argued that the studies *inter alia* did not adequately disentangle trade policy effects from other influences. Srinivasan and Bhagwati (2001) also highlight the limitations of cross-country regression analyses, while observing that most such analyses find benefits from open trade policies and, more importantly in their view, that various nuanced, in-depth case studies of the effects of countries' trade policies on growth support the case for open trade policies.

Countries that trade extensively with one another tend to exhibit a higher incidence of income convergence than other countries. Moreover, trade-related convergence does not appear to have come at the expense of the wealthier countries. In fact, not only have the relatively poorer liberalising countries been able to move to higher and steeper growth paths, so have their wealthier trade partners. In sum, the results [of the study] suggest that trade provides an important contribution toward the economic growth of nations — in particular, for those countries that are lagging behind their trade partners — and hence also potentially faster alleviation of poverty (Ben-David and Winters 2000, 5).

Despite deep reductions in protection from eight rounds of multilateral trade negotiations, trade discrimination persists because of preferential trade agreements and through selective tariff reductions by product, which have had the effect of discriminating against some countries' exports. For example, the exclusion of agricultural goods, textiles and clothing has disadvantaged developing countries. Accordingly, much can still be done to improve economic welfare by reducing restrictions and discrimination in trade.

While trade alone cannot overcome all problems in developing countries, openness to trade *is* an essential part of economic development and poverty alleviation (box 1.1). As the economist and Nobel Laureate, Amartya Sen, said during the recent *Deakin Lectures* in Melbourne:

...there is much evidence that the global economy has brought prosperity to many different areas of the globe. Pervasive poverty and 'nasty, brutish and short' lives dominated the world a few centuries ago, with only a few pockets of rare affluence. In overcoming that penury, both modern technology and economic interrelations have been influential. And they continue to remain important today. The economic predicament of the poor across the world cannot be reversed by withholding from them the great advantages of contemporary technology, the well-established efficiency of international trade and exchange, and the social as well as economic merits of living in open rather than closed societies (Sen 2001).

At the domestic level, while it is difficult to isolate the separate effects of particular microeconomic phenomena, Commission research (Parham 1999, PC 1999) strongly suggests that the reduction in Australia's trade barriers and associated economic restructuring over the last two decades has contributed to recent productivity growth, and to our economy's increased flexibility in the face of foreign economic disturbances. By a range of indicators, Australian firms have become much more innovative and productive. Over the 1990s, Australia's measured productivity growth accelerated to rates rivalling the so-called 'golden age' of the early post-war years.² (on page 5) And despite the crisis which enveloped several of our major markets in Asia, rapid import growth has been matched by export growth, with Australia's trade participation as a proportion of GDP now a third higher than it was in the mid-1970s.

Box 1.1 Trade liberalisation, inequality and poverty alleviation

While average living standards have risen dramatically over the 20th century, critics of trade liberalisation (and globalisation) point to claims of a growth of inequality between the world's rich and poor and the continuing extent of poverty in the world — some 1.2 billion people remain in absolute poverty.

However, based on detailed research, it is not clear that trade liberalisation is responsible for widening the gap between the world's rich and poor — and may in fact be narrowing it — for three reasons:

- Contrary to popular perceptions, some recent studies suggest that global inequality has begun decreasing in recent years, not least because of the substantial improvement in living standards in developing countries in East Asia.
- There is strong evidence that countries that trade extensively with one another generally exhibit a higher incidence of income convergence than those that do not, with the poorer countries closing up on the (also rising) income levels of their wealthier trading partners.
- Even in the case of those countries within which inequality has been increasing, it appears that this is mainly due to technological change, not trade liberalisation.

What *is* clear is that trade liberalisation has contributed to a substantial improvement in the material living standards of many of the world's poor and, in the process, to the alleviation of absolute poverty. Notwithstanding significant population growth over the 20th century, economic growth — facilitated in part by trade liberalisation — made the poorest quarter of the world's population almost three times richer, and the proportion of people in absolute poverty has declined.

Further, those countries that have shut themselves off from the rest of the world have done so at the expense of the living standards of their own people — including access to basic healthcare, education and other community services:

- There is evidence that 'self-reliance' (or import-substitution) strategies have performed poorly compared with export-oriented development strategies. Much of Africa and Latin America has suffered from poor growth rates, while East Asia has prospered with the largest and most rapid reduction in poverty in history, notwithstanding the temporary setback caused by the recent financial crisis.
- Many of the poorest countries — for example, Myanmar, Sierra Leone, Rwanda, Guinea-Bissau, the Republic of Congo, Chad, Burundi, Albania and North Korea — clearly are not in that state because of open trade policies. Rather, responsibility lies with internal institutions and policies and other factors inimical to economic growth such as political instability, poorly defined property rights, civil unrest and disease.

Overall, although many of the world's people continue to live in poverty, open trade policies have helped to substantially increase the living standards, not only of the world's rich but also of many of the poor, and thereby reduced the proportion of people living in absolute poverty.

Source: PC (2000b), Nankivell (2001) and references cited therein.

Importantly, the case for reductions in Australia's trade barriers does not rest on notions that foreign countries have already reduced, or will also reduce, their trade barriers. The main benefits of trade reform come from the economic efficiencies created within a country that opens itself to the pressures and opportunities of international competition, *irrespective of the trade barriers or subsidies which may prevail abroad*. For example, in relation to the free trade commitments made by APEC members in Bogor, McKibbin (1997) estimated that the gains to Australia from unilaterally meeting its own commitments would account for almost 90 percent of the gains which it would accrue if all APEC countries met their commitments. Nevertheless, Australia stands to gain additional benefits if its trading partners make further reductions to their trade barriers too.

While it is sometimes argued that Australia should retain trade barriers for use as 'negotiating coin' in trade negotiations, the Commission has found that unilateral liberalisation need not reduce Australia's negotiating strength. This is partly because trade negotiations in international forums, such as the WTO, usually involve discussions about offers to place restrictions on the maximum barriers for individual categories or classes of goods and services — that is, bound restrictions rather than the often lower restrictions actually applied. Where 'negotiation coin' can come from the binding of liberalisation already undertaken, there is no benefit in delaying liberalisation. Further, while Australia's negotiating strength is constrained by its small share of world trade (less than 1 percent), some consider that unilaterally reducing or eliminating protection demonstrates 'moral leadership' that can increase Australia's leverage in trade negotiations (PC 2000c). In any case, as most gains from trade reform arise from domestic liberalisation, the Commission considers that governments should generally proceed with beneficial domestic reforms, once identified, without awaiting multilateral negotiations.

When reducing protection, countries expose some of their industries and workers to adjustment and transition costs. The Commission has considered adjustment issues in several inquiries on industry assistance matters, and will release a research paper on these issues shortly (PC 2001). In brief, there is clearly a role for government to

² The Commission's findings of a productivity surge in the 1990s attributable in part to microeconomic reform have been challenged on two grounds. First, Quiggin (2001) argued that evidence of a 1990s productivity surge, relative to earlier decades, had disappeared in revisions to ABS productivity estimates. However, the ABS revisions affected affected growth rates in all periods, with relativities between decades largely unchanged. Second, Brain (2001) attributed the 1990s productivity growth surge to a 'Verdoorn' effect (in which output growth leads to labour productivity growth due to greater greater specialisation and other scale effects) rather than to microeconomic reforms. However, his calculations *inter alia* assumed that Verdoorn effects applied more broadly than manufacturing and certain other sectors (as normally considered), and he wrongly compared a 'Verdoorn adjusted' productivity series to multifactor productivity growth, rather than the (higher) growth in labour productivity suggested by the theory.

balance the benefits of liberalisation against these costs and to provide appropriate assistance to those adversely affected. Even so, adjustment pressures from changing international competitiveness can only be delayed or shifted to others within the economy: they cannot be avoided. By strengthening the economy overall, trade liberalisation adds to a country's ability to maintain or improve living standards while dealing with pressures for change.

Social and environmental effects

As well as economic effects, trade has had an array of social and cultural effects over the centuries. By engaging in trade, people have been exposed to different ideas, races, cultures, religions, leisure pursuits, products, ways of doing things and social customs. These experiences, while often unsettling at first, have come to be seen by many as having brought benefits for humanity's development.

In some cases where governments are concerned about cultural integrity, trade protection may play a role but may not give an efficient solution. It is important, therefore, that any cultural rationales for protection be scrutinised closely in trade negotiations, and that the costs of protection to all should be highlighted. This is particularly important with respect to agriculture where some countries' subsidies and restrictions on market access, justified in part on cultural grounds, harm Australian producers and many in developing countries, as well as most of the citizens of the countries providing the protection.

The relationship between trade policies and the environment is complex. Historically, rising affluence and population growth following the industrial revolution have placed increasing demands on the environment. There is now clear evidence of environmental problems in particular parts of the world, although elsewhere certain environmental indicators are improving. Trade, by facilitating global growth, has indirectly contributed to these impacts. As the environmental effects associated with past approaches to economic growth have become clearer, so has the role that trade can play in 'greening' economic activity. Trade can facilitate the global diffusion of pollution abatement products and clean production technologies. It can also promote more efficient patterns of production and resource use between countries, thereby allowing existing living standards to be maintained at less environmental cost. And as countries develop, the higher national incomes which trade helps sustain can provide governments with the resources — and community support — to treat environmental problems.

From a policy perspective, environmental problems are not caused by trade itself, but rather by *any form of economic activity where environmental policies are deficient*. Hence, what really matters is not whether trade occurs, but whether the environmental policies applying to any form of commerce are appropriate.

Environmental problems are best addressed using direct, properly evaluated policies. Trade sanctions are a blunt instrument for addressing environmental problems (see section 3.2).

1.2 The contribution of the WTO system

The WTO has been the subject of considerable debate recently, both within Australia and overseas. Critics have charged it with, among other things, being an undemocratic world government, anti-small country, and driven by the interests of corporations. While the WTO can be improved, many of the criticisms reflect an inaccurate understanding of the institutional character, history and role of the WTO. As discussed below, the Commission considers that the WTO system provides important benefits, particularly for small and medium countries like Australia.

The WTO (box 1.2) is essentially an international forum where sovereign governments negotiate agreements — which include constraints on their own actions — to foster an open trading system. Membership is not compulsory: governments choose to join the WTO for the benefits they believe the system brings. All WTO decisions are formally taken by a Council comprising all member governments.

Several aspects of the multilateral trading system have been designed to protect the interests of small countries. Decision-making is by negotiation and consensus. This ensures that smaller countries at least have a voice and that large trading nations and regional groups cannot altogether ignore their interests — even though the negotiating process has not always involved full participation by developing countries (see section 2.1). WTO principles require members to apply their trade rules in a transparent and non-discriminatory manner, which helps member countries with limited bargaining power. Other provisions protect smaller nations from arbitrary and discriminatory changes in the application of trade rules (box 1.3), while providing developing countries with special and differential treatment.

The WTO, and its predecessor the GATT, have played a pivotal role in reducing protection worldwide and thus promoting trade. As noted earlier, since the establishment the GATT in 1947, average tariffs on manufactured goods in industrialised countries have fallen from 40 percent to 4 percent. World trade has increased 18-fold (figure 1.1). Agreements have also been reached dealing with non-tariff barriers to trade, including subsidies, ‘contingent protection’, quarantine and intellectual property.

The WTO’s strengthened dispute settlement process makes large and small countries alike accountable, and provides a forum where countries can enforce

Box 1.2 The World Trade Organization

The WTO provides a framework of rules for international trade. This framework was established in 1947 by 23 countries signing the General Agreement on Tariffs and Trade (the GATT). It has evolved through eight successive rounds of negotiations to cover goods, services and trade-related aspects of intellectual property. There are currently around 140 members of the WTO, with a further 30 countries — including China and the Russian Federation — waiting to join.

The main functions of the WTO are to:

- administer and implement the trade agreements which together establish the WTO;
- provide a forum for multilateral trade negotiations;
- monitor national trade policies;
- assist in resolving trade disputes; and
- cooperate with other institutions involved in global economic policy.

WTO agreements and decision-making processes

WTO agreements are negotiated and signed by member governments. In the trade negotiations, decisions are taken 'by consensus' of all member governments.

The WTO negotiating process contains no formal channels for input from either business, union or community interest groups, although member governments are free to consult with such groups in determining their negotiating goals and strategies.

Dispute resolution processes

Where a trade dispute occurs, WTO members are committed *not* to take unilateral action against perceived violations of their rights. If conciliation is unsuccessful, the parties in dispute must instead argue their case before an independent panel — with appeals to a separate body possible. The outcome is then confirmed by the Dispute Settlement Body, constituted by all the member governments.

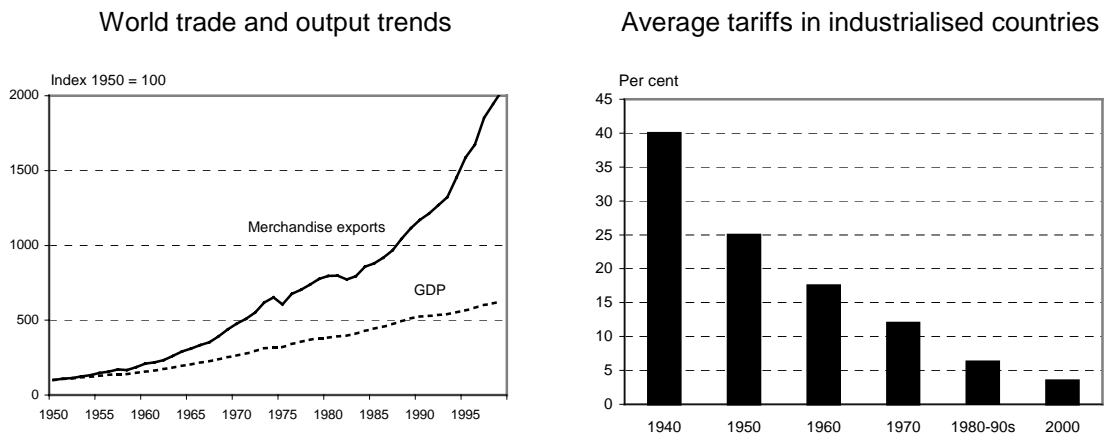
The WTO's Geneva-based Secretariat does not have any role in the enforcement of the legal rights and obligations of member countries, although it can provide some forms of legal assistance during the dispute resolution process.

Dispute resolution options

Where a member government is found to have breached its agreed trade obligations, it is expected to abide by the rulings and findings of the Dispute Settlement Body.

Member countries have flexibility in how they respond to rulings that they are in breach of their trade commitments. The offending country can: change its own law or regulation to make it consistent with its obligations; compensate the aggrieved country by lowering other trade barriers or by other measures; or do nothing and face possible 'proportional' retaliation by the affected party.

Figure 1.1 **World GDP, merchandise exports and tariffs, 1940/50–2000**



Data sources: WTO (1998, 2000).

obligations. Unlike earlier GATT arrangements, where disputes could only be resolved by consultations between the parties involved, an offending government has to accept a final dispute settlement decision, or face trade sanctions. The new dispute settlement mechanism has provided many benefits to Australia and other smaller countries, including:

- improved access to foreign markets;
- an opportunity to challenge marketing restrictions;
- a greater ability to influence large countries to abide by the rules; and
- disciplines to guard the wider interests of Australian consumers, producers and taxpayers against the protectionist claims of domestic interest groups (box 1.3).

Some significant trade barriers and distortions have persisted despite the work of the GATT and the WTO. For example, the United States and European Union have used a selective approach to liberalisation that has effectively discriminated against producers of textile and agricultural products — which in the past were largely excluded from negotiations. There are also deficiencies in WTO provisions covering regional trade agreements, anti-dumping and rules of origin, among others. In addition, there is scope to improve the dispute settlement process further — the WTO itself has identified procedural and legal aspects where improvements could be made. The new dispute settlement procedures have been so successful in some ways that they risk being burdened or even fractured by what are essentially political matters, such as where trade sanctions are used against third parties in political disputes.

The Commission sees the key task now as being to build on and improve further the rules-based framework.

Box 1.3 How the WTO has benefited Australia: some examples

The key trade rules

WTO provisions require members to apply their trade rules in a transparent and non-discriminatory way, thereby helping countries with limited bargaining power:

- The *most-favoured-nation* rule means that all WTO members have to be accorded as favourable access to a particular country's market as any other country (with limited exceptions for free trade agreements, customs unions and preferential arrangements with developing countries). The benefit to small member countries is illustrated by the outcomes achieved from the series of bilateral negotiations China is undertaking as part of its accession to the WTO. Australia negotiated reduced Chinese tariffs, for example, on wine (down from the current 65 percent to 20 percent) and butter (down from 50 percent to 25 percent). The European Union negotiated even lower tariffs (14 percent on wine and 10 percent on butter). Application of the most-favoured-nation rule means that the most favourable concessions negotiated by each of China's trading partners will automatically become available to all WTO members.

Other provisions give a measure of certainty and protect smaller nations from arbitrary and discriminatory changes in the application of trade rules:

- The requirement to accord *national treatment* means that, once foreign products have passed quarantine and customs, they must not be treated less favourably than domestically produced goods. This means, for example, that the European Union could not apply quality or health-based standards to imports of Australian grains that it did not apply to its own producers. As a result of telecommunications negotiations, foreign telecommunications companies have the same conditions of access to domestic networks as national companies.

Benefits of dispute settlement

Nearly 200 disputes had been brought to the WTO between 1995 and May 2000. Fifty of these were initiated by developing countries. The US and the European Union have registered the most complaints — 60 and 50, respectively — but they are also the most frequently cited for not complying with WTO rules. Of the 77 disputes resolved, 41 were resolved without going to adjudication by a panel. Australia has been involved, or had an interest, in 32 disputes, including five as a respondent (of which two involved salmon quarantine issues and two related to automotive leather).

Australia and other smaller countries have gained many direct benefits from the dispute settlement mechanism, including:

- *a faster opening of markets* — for example, India, having lost a case taken by the US in the WTO, agreed to remove quantitative restrictions on agricultural, textile and other industrial products two years earlier than previously negotiated with other members, including Australia;

continued

Box 1.3 continued

- *countering market-closing measures* — for example, the US, having lost the case brought against it by Malaysia, Thailand, India and Pakistan, altered its shrimp import regulations, thereby allowing Spencer Gulf prawns access to the US market. This had previously been denied because Australia did not mandate turtle-excluding devices on fishing nets, despite the extremely low incidence of sea turtles in that fishery;
- *the opportunity to challenge marketing restrictions* — for example, Australia's claim that Korean regulations discriminate against Australian beef by confining sales of imported beef to specialised stores and limiting the manner of its display has been upheld, as has a similar claim made by the US;
- *requiring large countries to abide by the rules* — for example, the findings against the US tax treatment of export income and the European Union banana import regime demonstrate that even powerful countries are not 'above the law' even if, as in the long-running banana saga, they delay bringing their arrangements into conformity with their treaty obligations; and
- *securing the interests of Australian consumers, producers and taxpayers* — notwithstanding recent controversy over imports of fresh salmon, it is in Australia's overall interests for the dispute settlement system to require science-based quarantine protocols. Such protocols help to prevent Australian exports being discriminated against in foreign markets (as they have done with the finding that Japan's testing requirements for different varieties of some fruit were inconsistent with its treaty obligations). And they limit the extent to which Australia can use its quarantine system as an economic protection device — which as noted earlier would impose costs on consumers and other Australian industries. Similarly, leaving aside the adverse domestic implications of subsidy assistance, Australia's interests would not be well served if other countries had unchallenged rights to emulate the subsidies paid to the automotive leather producer, Howe Leather.

1.3 Shoring-up national support for the international trading system

Some misconceptions about the GATT/WTO system arise from the technical language of trade negotiations — 'concessions', 'negotiating coin', and 'retaliation' — which conveys the impression that trade is a zero-sum game, rather than a source of mutual advantage. When denying claims by interest groups for special treatment, governments are prone to blame 'WTO rules' rather than to cite domestic benefits or national interest grounds.

The GATT/WTO bargaining approach to trade negotiations, based on the reciprocal exchange of 'concessions' (for example, tariff cuts), allows governments to sell the

benefits to particular domestic constituencies, such as exporters, while playing down the effects of increased imports, which benefit consumers and users but reduce domestic production of import substitutes. The downside of this approach is that it reinforces a mercantilistic view of the gains from trade liberalisation — that increased exports are good for a country whereas imports are not. As Krugman (1997, 113) put it:

The compelling economic case for unilateral free trade carries hardly any weight among people who really matter. If we nonetheless have a fairly liberal world trading system, it is only because countries have been persuaded to open their markets in return for comparable market-opening on the part of their trading partners. Never mind that the ‘concessions’ trade negotiators are so proud of wresting from other nations are almost always actions these nations should have taken in their own interests anyway; in practice, countries seem willing to do themselves good only if others promise to do the same.

Opposition to the GATT/WTO has increased as governments have collectively agreed to extend the influence of its rules beyond tariff and quota barriers in merchandise trade to include trade in services, rights to provide services from within foreign countries and regulation of domestic subsidies, quarantine and intellectual property protection. These expanded areas of commitment have been supported by the more robust dispute settlement process. Yet, as Hudec (1999, 12) has observed, the expanded international obligations have not been matched with greater resolve at the national level:

The new WTO system asks for a stronger political commitment because it sets the bar higher. Yet it is difficult to identify any major changes in national political life in the major WTO countries that will make their political systems more receptive to WTO legal discipline than they were in the decade or two before the WTO came into being.

Events in Seattle and since are a reminder that pressure group politics remains a potent force, domestically and internationally. If not adequately addressed, it could impede further international liberalisation of trade and investment, and sacrifice potential improvements in development prospects and living standards.

Responding to the concerns of interest groups is a matter primarily for domestic democratic processes. Some of the more responsible critics have a point when they argue that corporations find it easier than consumers and non-governmental organisations to attract the ear of national governments. Trade is not only a business issue: trade liberalisation is beneficial only if it leads to, or at least provides a means of, improving the lives of a country’s citizens (and others about whom they are concerned). The legitimate concerns and agendas of interest groups therefore need to be addressed at the national level. Groups that feel disenfranchised nationally will target the WTO itself, which as an inter-governmental body is neither designed nor equipped to accommodate them.

There are governance issues in the WTO that need to be addressed. Resource constraints impede the ability of many developing countries to identify and to defend their interests and to participate in WTO activities. These countries find it costly to implement WTO agreements and have difficulties meeting their commitments. The growth in WTO membership means that more inclusive ways of structuring negotiations may need to be found. The Director-General of the WTO, and his designated successor (Panitchpakdi 2000), advocate a substantial action agenda for the organisation. Australia's stake in the ongoing effectiveness of the WTO provides a good reason to support structural and procedural reforms, to facilitate negotiations and to finance the implementation of agreements.

Ultimately, however, the future of the WTO system depends on achieving a better understanding within each member country of the benefits and costs of its own trade liberalisation. That requires political leadership to articulate the benefits of freer trade and the adjustment consequences. In most countries, groups who benefit from protection and other anticompetitive arrangements are a dominant influence. As the Australian experience shows, greater domestic transparency of the costs of protection (and their distribution) can be an effective counterweight, promoting wider public understanding of what is at stake in trade reform.

The role of domestic transparency in underpinning liberal trade was recognised in the early stages of the Uruguay Round negotiations through the work of the negotiating group on the Functioning of the GATT System. As the round progressed, the question of institutional arrangements to achieve greater transparency was displaced by the Trade Policy Review Mechanism. This vehicle for international surveillance of member countries' trade policies has exposed shortcomings in national trade policies. Nevertheless, it remains an external mechanism, largely outside the debate about national trade policies.

The establishment of institutional vehicles within each country to provide information on the domestic costs and benefits of protection and other assistance to industry would not only contribute to better informed internal debates on trade policy, thus facilitating domestic liberalisation, it also could help to shore-up support for the WTO system. This proposal has been most recently expounded in recent submissions to the Joint Standing Committee on Treaties' *Inquiry into the WTO* by former Industries Assistance Commission chairman, Bill Carmichael, and Professor Ron Duncan from the National Centre for Development Studies. They make a compelling case that the issue should be considered as part of the Qatar talks or in the subsequent work program of the WTO (Carmichael and Duncan 2001).

1.4 Conclusion

The Commission considers that liberal trade policies have generated significant benefits, both for the global community and for Australians. While it remains true that our own liberalisation offers the main benefits for Australia, the WTO system has provided a stable, rules-based multilateral framework which has brought widespread benefits. This is not to say that the WTO system cannot be improved. The Commission recommends that the Australian government continue to support trade liberalisation and increase its efforts to maintain and improve the WTO system.

2 Key agenda items

To assist in formulating Australia's approach to the WTO Ministerial Conference in Qatar and subsequent negotiations, DFAT invites comment on the agenda of future multilateral trade negotiations, including the subject matter, content and timetable for negotiations.

Given the potential gains from further trade liberalisation, Australia's general goal at the Qatar talks, and in related WTO trade negotiations, should be to push multilateral trade reform generally, while giving particular weight to those areas in which Australia stands to gain most.

In determining its negotiating position and the matters that should be placed on the agenda, Australia naturally needs to take into account the problems evident at the 1999 Seattle Ministerial Conference and negotiating positions taken by the key players in the preparatory talks for Qatar.

There has been much debate about the failure to launch a 'Millennium Round' of multilateral trade negotiations at Seattle. Several factors appear to have contributed, including:

- inadequate preparation of an agenda for Ministers to consider;
- the dual role of the United States in being both chair and major player;
- a lack of discussion with developing country members, which now comprise more than two-thirds of the WTO membership; and
- pressures to link a proliferation of 'link' issues — such as labour standards and environmental matters — to the WTO negotiating agenda.

There are signs that preparatory meetings for the Qatar Ministerial Conference are facing similar difficulties.

Some developing nations are refusing to discuss the agenda for a Millennium Round before a review is undertaken of the balance of the benefits from the Uruguay Round negotiations, and the costs of implementing them. The OECD countries regard these issues as matters to be discussed as part of the 'built-in' agenda for trade negotiations, as mandated by the Uruguay Round. Many developing countries also remain opposed to attempts to link matters such as labour and environmental issues to WTO agreements. On the other hand, some observers have detected a shift

in major business groups in the United States towards the European position of seeking such linkage (Hartcher 2001). Nevertheless, developing countries will need to be satisfied before effective negotiations can commence, and that may require concessions by developed countries and could reduce the scope of the agenda.

A further constraint on progressing trade liberalisation within the WTO has been the increasing reluctance of the United States to assume its traditional leadership role. This was evident in Seattle and was attributed in part to domestic political considerations in an election year. The changing nature of the WTO, including the greater difficulties in achieving consensus given the more diverse range of interests now represented, also may have increased the incentives for the United States to promote regional trade agreements, rather than push ahead with multilateral reform.

On the other hand, a recent statement by the United States President on the benefits of trade liberalisation offers some hope that the current US administration may be serious about a new round. President Bush said:

By failing to make the case for trade, we have allowed a new kind of protectionism to appear. It talks of workers, while it opposes a major source of new jobs. It talks of the environment, while opposing the wealth-creating policies that will pay for clean air and water in developing nations. It talks of the disadvantaged, even as it offers ideas that will keep many of the poor in poverty. Open trade is not just an economic opportunity. It is a moral imperative. Trade creates jobs for the unemployed. When we negotiate for open markets, we are providing new hope for the world's poor. And when we promote open trade, we are promoting political freedom (Bush 2001).

Against this background, Australia needs to balance what is desirable with what is achievable within the WTO forum. In some important respects, part of the agenda is set. The Marrakesh Declaration that concluded the Uruguay Round included a 'built-in agenda' for talks on agriculture, services, dispute settlement and intellectual property. Other matters to be considered at Qatar include:

- whether a new round should be formally launched and, if so, what time-frames for negotiations and whether outcomes should form a 'single undertaking';
- whether market access for manufacturers, food safety, biotechnology and e-commerce should be included;
- what attention should be given to 'link' issues such as investment, competition policy, the environment, etc; and
- developing countries demands on how the anticipated benefits and implementation of the Uruguay Round commitments should be achieved.

In this section of the submission, the Commission considers Australia's interests in key agenda items — namely trade and development, agricultural trade and trade in services.

2.1 Trade and development

Developing countries' concerns

Developing countries' interests were at the root of many of the problems that impeded preparations for a new WTO round in Seattle, and most of those issues remain important in the discussions in the lead up to the Qatar Ministerial meeting.

One problem that became evident in Seattle was the process by which developing countries views are accommodated in trade negotiations. The WTO operates mainly by consensus, which in theory requires all member countries to accept, or at least not object strongly to, the balance of 'concessions' offered and received before an agreement can be concluded. The composition of GATT/WTO membership has changed markedly since the Tokyo Round was concluded in 1979. As noted earlier, developing countries now account for two-thirds of members. In Seattle, developing countries became aware that they were not well represented in 'Green Room' negotiations, where the major players thrash out agreements. New machinery will have to be developed for the next negotiations to incorporate developing countries more fully in the process.

Many developing countries now also realise that previous multilateral trade agreements have not served their interests as intended. The Uruguay Round final agreement allowed developed countries to avoid many important reforms while imposing high implementation costs on developing countries. Earlier rounds also favoured trade growth among developed countries (see box 2.1).

Some developing countries are now unwilling to contemplate new trade negotiations in areas beyond those mandated in the Uruguay Round final act, unless their outstanding complaints are dealt with. Although the 'built-in' agenda is itself extensive, it excludes the new 'link issues', such as trade and environment, and recent concerns about biotechnology, food safety and genetically modified plants — issues on which developing countries are reluctant to negotiate. On the other hand, market access for manufactured goods, where developing countries stand to make important gains, would not be included in the negotiations either. Some developing countries believe that tariffs on products of export interest should be reduced as a preliminary to any new round. If the developing countries can unite and establish a common position on these important matters, they could exert real influence in the preparatory discussions towards a new round.

By the same token, developing countries have strong incentives to engage in a new round. In the past twenty years, many developing countries have prospered from growing economic interdependence and their own domestic reforms. Developing countries have increased their export share in world merchandise trade (20 percent

in 1973, 28 percent in 1999). The least developed countries have progressed little, but this lack of development is attributable to factors other than trade. The opportunities to spread economic development through trade reform are still evident in those countries with the institutional framework to benefit from it. Of course, access to technology and capital are essential too, while social and political instability is a major reason for poor economic performance. A new WTO negotiating round would provide many opportunities to promote economic development, particularly if an attempt is made to redress existing imbalances in trade liberalisation that have evolved from earlier negotiations.

Box 2.1 Developing countries' concerns about previous rounds

- *Inadequate Uruguay Round reform by developed countries:* Many developing countries' governments do not believe they have received the economic benefits promised to them when they accepted the 'single undertaking' requirement in the Marrakesh Declaration. The 'backloading' of the agreement on textiles and clothing (ATC) means that most of the improved access to OECD markets under the ATC will not occur until the final phase in 2005. Moreover, some OECD countries have resorted to anti-dumping and safeguard measures that have reduced anticipated export gains for developing countries. Similarly, reductions in agricultural protection by OECD countries agreed in the Uruguay Round have been offset by new subsidies and other 'hidden' forms of protection (for example, administrative procedures in some countries).
- *Implementation costs of Uruguay Round commitments to developing countries:* Many developing countries (especially the least developed countries) have found difficulty in meeting their Uruguay Round obligations under TRIMs and TRIPs, even with extended transition periods and some (inadequate) technical assistance. Many of them lack the financial, legal and administrative resources to implement their commitments or to use WTO provisions, such as dispute settlement. Many developing countries want a general waiver from Uruguay Round obligations, while most OECD countries want a case-by-case approach. The United States is threatening to take some of the lagging WTO members to dispute settlement.
- *Unequal effects of earlier agreements:* Several studies in the 1960s and since have shown that developing countries' growth was handicapped by biases in the historical process of trade liberalisation under the GATT, which focused on goods produced and traded among developed countries. Developing countries accepted trade preferences (eg GATT Part IV and the Generalised System of Preferences) that were compatible with their choice of import-substitution strategies for development. This amounted to non-participation in GATT negotiating rounds, and developing countries were discriminated against in exports such as processed materials, tropical and temperate agricultural produce and labour-intensive manufactures, both in terms of tariff levels and 'grey area' protection (anti-dumping, safeguards, etc). This experience has alerted some leading developing countries to oppose 'sector-by-sector' negotiations favoured by some OECD countries, because they can be used to discriminate by product.

There are risks to developing countries ‘over playing’ their hand. Countries wishing to extend the scope of the WTO rules may agree among themselves to regional trade agreements or other ways to discriminate among WTO members. An effect could be to split developing countries into factions under the influence of major players’ inducements, such as regional trade agreements (RTAs), trade preferences or financial aid for adopting labour or environmental standards, acceptance of global environmental treaties, etc, as offered in the recently agreed Cotonou Treaty.

Australia’s negotiating position

Against this background, there are three particular reasons for Australia to support developing countries in their efforts to redress the perceived imbalance of past trade liberalisation initiatives.

First, a major breakdown of the WTO system is in no country’s interest, and especially not for Australia, which relies heavily on trade and thus on the multilateral trade rules of the WTO. Indeed, if the round is not launched, the likely growth in RTAs that would follow threatens to increase discrimination in trade, particularly in terms of ‘hub and spoke’ preferential agreements (see section 3.1). As developing countries’ concerns were a stumbling block at Seattle, it will be necessary to meet at least some of their concerns if a new round is to commence.

Second, Australia has common interests with many developing countries in the WTO agenda. For example, several important developing countries are members of the Cairns Group and will want to ensure that substantial progress is achieved in the agricultural negotiations. At the same time Australia has an interest in expanding the scope of the General Agreement on Trade in Services (GATS), as do some developing countries. In relation to trade ‘link’ issues such as labour standards and the environment, the Australian Government has not favoured including these matters in WTO negotiations. The Commission, too, sees good reasons to keep these matters off the negotiating agenda, notwithstanding their importance (section 3.2). This aligns with the position taken by developing countries. Hence, emphasising the importance of promoting the interests of developing countries could provide additional leverage for Australia in these important areas.

Third, supporting developing countries’ participation in the world trading system, and working to ensure that the system promotes development, is one way in which Australia can contribute to its own humanitarian goal of reducing poverty abroad.

Australia should support several trade liberalisation initiatives which would help developing countries. As well as pushing for more liberalisation of agriculture and trade in services (discussed further below), Australia should support increased

technical assistance to allow developing countries to fulfil their obligations under WTO agreements, which can only strengthen the institution. Similar incentives exist for promoting trade facilitation, which has been accepted as necessary in the WTO but has so far received little financial support.

2.2 Agriculture

Past trade agreements have done little to restrict agricultural support programs. Agriculture was largely exempt from the early rounds of the GATT. The Uruguay Round introduced some notional limitations on agricultural assistance, but the exemptions and the way in which the process of tariffication was allowed to proceed — countries have been able to convert quotas into bound tariffs higher in value than the pre-existing quota — have enabled developed countries to maintain high rates of assistance/protection for agriculture. Indeed, recent declines in farm prices and the provision of additional subsidies in the United States have raised actual assistance for agriculture to pre-Uruguay Round levels. The highest levels of agricultural assistance are provided by European Union (EU) countries, Japan and the United States.

Agriculture is part of the ‘built-in’ agenda from the Uruguay Round, and technically new negotiations have already commenced. In reality, no major players will reveal their hands until the agenda for a new round becomes clear.

Trade reform in agriculture could bring significant gains to Australian farmers. Australia is one of the world’s most efficient exporters of beef, wheat, sugar, dairy products and rice — which are all among the most highly protected agricultural products in global terms. These products also loom large in Australia’s total rural production (Stoeckel 2000).

There would also be significant global benefits from agricultural reform. Quantitative studies have estimated that liberalisation of post-Uruguay agricultural trade barriers would enhance global welfare by at least US\$50 billion per year.³ The bulk of these gains would accrue from a better allocation of resources within the

³ Commission staff estimated that liberalisation of post-Uruguay agricultural trade barriers would enhance global welfare by around US\$50 billion (Dee and Hanslow 2000), using the Foreign Trade Analysis Project (FTAP) model of the global economy. In a similar exercise, Hertel (1999) estimated the gains at \$160 billion. The differences reflect, among other things, the fact that Hertel assumed no effective Uruguay liberalisation post-1995, as well as differences in the income base used in the two studies (see Dee and Hanslow 2000, 17). A DFAT (1999) study estimated that eliminating global trade barriers and subsidies to agriculture would generate a global benefit of \$150 billion per year. The Commission has been unable to reconcile the higher results in the DFAT study with its own estimates, due to a lack of detail in the DFAT study.

economies of North America, the European Union and Japan. There would also be benefits from an environmental and development perspective.

The Commission is not convinced that the ‘multi-functionality’ argument put forward for maintaining assistance over the long term has merit. For example, the European Union has argued that agriculture provides societies with ‘external’ (or non-market) benefits such as soil and water conservation, habitat for threatened species, certain benefits associated with the maintenance of rural communities, and aesthetic benefits in the form of pleasant country vistas. However, as Lindsey et al. (1999, 15) point out:

Even if one accepts that those positive spin-offs from agriculture exist, they would not justify a policy of protecting and subsidising domestic farm production. First, the positive externalities need to be weighed against possible negative externalities such as pollution from pesticides and fertilizers. Second, they need to be compared with the positive externalities that might be created in sectors that would expand if agriculture were not artificially supported. Finally, if governments want to encourage certain activities, any intervention should be focused as directly as possible on the desirable activity. For example, if Britain wants to preserve rural hedgerows because they look nice and provide shelter for small animals, then a direct subsidy for maintaining hedgerows would be more effective and less distortionary than is using trade barriers to indirectly subsidise nearby farm production by keeping commodity prices artificially high.

Accordingly, the goal of the agricultural negotiations should be to cut deeply into current levels of agricultural assistance. Together with other Cairns Group countries, Australia could seek:

- reductions in production subsidies, including by ensuring the United States maintains the integrity of the 1996 Farm Bill, and by seeking reforms of the EU Common Agricultural Policy beyond those envisaged in its Agenda 2000 reforms;
- the phasing out of export subsidies to bring agriculture into conformity with the general rules on export subsidies applied to manufacturing;
- reductions in tariff barriers, through the elimination of differences between bound and actual tariffs as well as the winding down of bound tariffs;
- reductions in tariff peaks through faster and deeper cuts to the most highly subsidised commodities;
- the elimination of new quantitative restrictions such as tariff-quotas, which sometimes have been introduced as ‘temporary’ assistance but which inevitably carry a risk of permanency; and
- limits to the scope for government-backed trading enterprises to distort trade in favour of domestic producers.

Clearly, Australia has a particular interest in encouraging multilateral reductions in protection in those areas of agriculture in which Australia is a major exporter or potential exporter, including beef, wheat, sugar, dairy products and rice.

2.3 Services

Services is an area of growing importance in the world economy. The services sector is increasing in size in developed countries, not least in Australia where it now accounts for around 80 percent of gross domestic product and employment. Services exports also account for around 20 percent of world trade (PC 2000a).

Restrictions on trade in services largely take the form of domestic regulations, such as licensing requirements, which restrict the access of service providers to the market. In some cases, there may be benefits associated with the restrictions that outweigh their costs. But in other cases, particularly in the case of discriminatory restrictions against foreigners, the effects are little different from a tariff.

The Uruguay Round was the first multilateral round to have services on its agenda. Most of the negotiations related to the architecture of the agreement — the General Agreement on Trade in Services — rather than protection levels. Under the GATS, countries put forward commitments to liberalise particular services industries independently of each other, or in response to a ‘request’ from another nation. The commitments set out the conditions under which foreign firms will be granted access to the particular industry in the economy of the country making the offer, but GATS does not specify the industries on which countries must make commitments, nor does it proscribe retention of significant market access barriers and/or discrimination against foreign firms.

Quantification of trade restrictions in services

During the Uruguay Round, member countries provided substantial qualitative information about their existing barriers to trade in services, but only in recent years have studies been undertaken which give a feel for the relative size and importance of those barriers.

Recent modelling work by Commission staff provides an indication of the benefits that could flow if Australia were successful in negotiating improved access to services markets with its trading partners. Dee and Hanslow (2000)⁴ projected an increase in world income of some US\$250 billion as a result of eliminating all post-Uruguay Round trade barriers. More than half of the gain would come from liberalising services trade. Australia’s annual income would be higher by about

US\$2 billion from global liberalisation of services trade. These results are the projected gains in annual income, about ten years after the liberalisation has occurred and the associated resource adjustments have taken place. While projections of this nature need to be interpreted with considerable caution, they provide an indication of the broad magnitude of the gains available from further liberalisation of services trade.

At the industry-by-industry level, recent work by Commission staff and others on selected services industries, for Australia and up to 37 other countries (table 2.1), gives some indication of sectors which might warrant the closest scrutiny. In particular, trade restrictions in the telecommunications sector are the highest of the industries studied. Within the professions, legal and accountancy services are generally more restricted than architectural or engineering services, and may thus warrant greater scrutiny. However, this body of work is insufficiently broad to give a complete picture of negotiating priorities. The size of restrictions in the health and education sectors is yet to be estimated, for example.

Even so, the work completed does suggest that some developing nations stand to gain significantly from reform to some of their service industries. It shows, for example, that current domestic regulations can inflate prices by over 100 percent in the case of telecommunications in Indonesia, and more than 60 percent in the case of banking in Malaysia.

Approach to the negotiations

Services are part of the 'built in' agenda agreed to at the conclusion of the Uruguay Round, and negotiations are currently under way.

The WTO has recently released a number of sectoral papers on services. They outline the nature of specific services, the structure of the services market, and commitments made under the GATS. The papers provide background information to stimulate discussion by Members on issues for services sectors. They show that members have made more commitments in financial and professional services than in other service sectors. Increasing the number and quality of commitments in the new negotiations will be a move towards further liberalisation and, in general, Australia should support such moves.

⁴ The effects of liberalisation were examined using version 4.1 of the FTAP model and database of world trade. The model was modified for services delivered via 'commercial presence' through the inclusion of bilateral foreign direct investment flows and to allow for income earned abroad. The model was used to examine the importance of multilateral liberalisation of services trade, relative to liberalisation of trade in agricultural and manufactured products (see Dee and Hanslow 2000).

Table 2.1 Restrictiveness indexes and price effects for selected services

	<i>Domestic Index^a</i>		<i>Foreign Index^a</i>		<i>Price effect^b</i> <i>(percent)</i>	
	<i>Maximum</i> <i>(country)</i>	<i>Australia</i> <i>(rank^c)</i>	<i>Maximum</i> <i>(country)</i>	<i>Australia</i> <i>(rank)</i>	<i>Maximum</i> <i>(country)</i>	<i>Australia</i> <i>(rank)</i>
Legal	0.33 (Austria, Japan)	0.27 (24/29)	0.58 (France, Turkey)	0.42 (10/29)	ne	ne
Accountancy	0.31 (India)	0.16 (12/34)	0.63 (Philippines)	0.41 (18/34)	ne	ne
Architectural	0.25 (Canada)	0.03 (12/34)	0.44 (Austria)	0.15 (12/34)	ne	ne
Engineering	0.2 (Austria, Germany)	0.04 (15/34)	0.39 (Austria)	0.08 (6/34)	14.5 (Austria)	2.8 (6/20)
Distribution	0.26 (Korea)	0.03 (5/38)	0.40 (Malaysia)	0.10 (7/38)	ne	ne
Banking	0.27 (Malaysia)	- (1/38)	0.65 (Malaysia)	0.12 (22/38)	60.6 (Malaysia)	9.3 (21/38)
Telecommunications	0.47 (Turkey)	0.04 (7/38)	0.80 (Turkey)	0.04 (7/38)	138.4 (Indonesia)	0.3 (8/37)
Maritime	0.28 (Korea)	0.13 (14/35)	0.64 (Philippines)	0.42 (21/35)	ne	ne

^a The restrictiveness index scores range from 0 to 1. The higher the score, the greater are the restrictions for an economy. The domestic index measures those market access barriers affecting both domestic and foreign suppliers. The foreign index measures these barriers and adds those barriers which apply to foreign suppliers alone. Hence, it represents the total hurdle facing foreign suppliers seeking to operate in the market. ^b The price effect of restrictions is measured as a percentage. ^c Rank refers to the position of Australia relative to other countries in the study, where 1 is the least restrictive economy. For example, 24/29 means Australia is the 24th least restrictive economy of the 29 economies included in the study — that is, there are five economies more restrictive than Australia. **ne** Not estimated. - Nil.

Sources: Kalirajan (2000); Nguyen-Hong (2000); Kalirajan et al (2000); McGuire and Schuele (2000); McGuire, Schule and Smith (2000); Warren (2000a); Warren (2000b).

There is a strong ‘in principle’ case for eliminating scope for any ‘national treatment’ restrictions, such as higher licensing standards for foreign suppliers than for domestic suppliers. Such discriminatory restrictions usually aim to restrict trade in services. The fact that they go beyond the restrictions imposed on domestic services providers immediately casts doubt on whether they are necessary to ensure competitive and efficient service sectors.

However, negotiations should also aim to improve market access for all entrants, not just foreigners. The studies reported in table 2.1 suggest that restrictions on market access generally have a larger impact on countries’ economic efficiency and income levels than do national treatment restrictions. Further, Dee and Hanslow

(2000) argue that liberalising trade for domestic and foreign service providers together should be a better approach than only reducing discriminatory restrictions on foreign service providers. This is because reducing discriminatory restrictions on foreigners alone can have a negative impact on the level of services supplied by domestic firms. It should result in lower prices and higher total sales, but domestic service suppliers will end up with a smaller share of this market. However, if restrictions that affect foreign and domestic service providers equally are reduced, all service providers will have the same opportunities to increase the amount of services they supply in an expanding market.

In terms of the breadth of the negotiations, the Commission sees merit in discussing reform in relation to all 12 GATS sectors. This is partly because most of the sectors appear to offer the scope for worthwhile reform. Another benefit of broad negotiations is that, with more items on the table, countries are more able to make satisfactory trade-offs. That is, given the usual approach to trade negotiations, any one country should be more able to commit to reform in its own highly restricted service industries if it receives a commitment by other countries to reduce their restrictions in other service industries. Such an approach may facilitate greater reform.

However, from the Commission's services work to date, it appears that trade restrictions on services are not evenly spread among countries. Rather, Asian and South American economies, in particular, appear to have higher restrictions in virtually all of their sectors than do developed nations. This means that there may be only limited opportunity to make trade-offs *within the services sector*.

In turn, this suggests that if the broad negotiations route is to be adopted, it will also be desirable to conclude a 'single undertaking' as part of a new round or to adopt a similar mechanism which facilitates the exchange of 'concessions' across sectors. Facilitating such trade-offs is desirable because it seems plausible that developing countries may be more willing to make 'concessions' in their services sectors if developed countries are willing to make concessions in relation to agriculture and manufacturing. Equally, and of particular importance for Australia, the governments of European Union countries, Japan and the United States may be more willing to offer concessions in agriculture if they can show to their constituencies that they have been able to obtain concessions in relation to services trade restrictions in developing countries.

Whether a comprehensive approach to negotiations is adopted or not, the 'tops down' reform of trade restrictions in services would be desirable, with the most restricted industries in the most restrictive economies being subject to the greater and/or earlier reform. Australia also has a particular interest in encouraging reform in markets in which Australian services firms are internationally competitive —

DFAT's consultations have already identified particular restrictions in overseas countries which Australian firms are keen to see reformed. Australia also needs to be prepared to offer its own 'concessions' to facilitate negotiations (although Australia generally should proceed with reforms that would be beneficial on a unilateral basis, independent of trade negotiation considerations). While the Commission's services work to date suggests that Australia's service industries generally are only moderately or lightly restricted, there still appear to be many sensible opportunities for Australia to make new commitments as part of any agreement on services. For example, there may be scope for Australia to participate in multilateral reforms in relation to maritime transport, and there are likely to be restrictions in relation to certain professions in which reform may be warranted.

Australia should also support stronger transparency mechanisms and necessity tests in all countries to review existing domestic regulation, and to vet new regulation, to ensure that it is not unduly restrictive. Indeed, the Commission's research on services has highlighted the inadequacy of current GATS schedules as a complete listing of barriers to services trade by sector. While the current talks are taking as their starting point the GATS architecture with its positive list approach, there is also a case for supporting the development of supplementary mechanisms to promote transparency. The Carmichael-Duncan proposal mentioned earlier would be one approach.

3 Other trade-related issues

In its Request for Public Comment, DFAT invites comment on any other matters which may be relevant for determining Australia's negotiating position for the forthcoming WTO Ministerial Conference.

In this section, the Commission comments on five trade-related issues, namely:

- regional trade agreements;
- the linkage of environmental and labour standards to WTO agreements;
- WTO agreements on the use of safeguards, subsidies, anti-dumping and countervailing measures;
- quarantine measures for SPS agreement; and
- international arrangements for foreign investment.

3.1 Regional trade agreements

While Australia is considering the agenda of a forthcoming round of WTO trade negotiations, it also needs to consider its position on two issues in relation to the recent proliferation of preferential trading arrangements (box 3.1).

- First, the current WTO framework contains rules designed to ensure that RTAs are not harmful to the economic interests of individual members or third parties, whether directly or through systemic effects on the multilateral rules-based system. Australia needs to consider whether these rules are sufficiently strong or well enforced to protect its interests, either as a participant or a bystander in RTAs, and independently of the benefits of any particular RTA to which we may or may not belong.
- Secondly, Australia needs to consider what impact, if any, the current proliferation of RTAs might have on the balance of interests in a new multilateral trade round.

Box 3.1 The GATT/WTO and the growth of Regional Trade Agreements

The term 'regional trade agreements (RTAs)' covers a wide range of economic arrangements between two or more countries. GATT Article XXIV allows customs unions and free trade areas on specific conditions, as an exception to the principle of non-discrimination. Two extensions are contained in the Enabling Clause to GATT Part IV, which allows 'differential and more favourable' treatment for developing countries, and GATS Article V which contains the same conditions on scope and coverage as GATT Article XXIV. Many RTAs now extend 'free trade' to require extensive harmonisation of policies among members, for example the European Union (EU) and Australia-New Zealand Closer Economic Relations (CER) agreement.

The expectation when the GATT was established was that such preferential trade arrangements would be few. However, in the period 1948-94, over one hundred regional trade agreements were notified to the GATT. By the end of 2000, another hundred or so agreements were being examined by the WTO Committee on Regional Trade Agreements (CRTA – see below). Many of these arrangements concern small countries (for example, East European countries) adopting bilateral arrangements with the EU or other large neighbours. In the 1980s, the US Administration announced it would adopt bilateral free trade arrangements with interested countries, which gave regionalism another push. The United States now has a number of RTAs with western hemisphere countries; NAFTA is the best known.

GATT Article XXIV was reviewed during the Uruguay Round. Annex 1A of the Marrakesh Declaration includes an understanding on the interpretation of GATT Article XXIV, which clarifies some ambiguities. However, it does not tackle key problems with preferential trading arrangements, such as overlapping RTAs (so-called 'hub and spoke' arrangements), exclusion of key traded sectors (agriculture), rules of origin, tariff uniformity, etc. The proliferation of RTAs undermines the principle of non-discrimination and elevates the reciprocal nature of liberalisation in recent times.

The CRTA was established in 1996 to examine the consequences of regional discrimination for the multilateral trading system. However, with all the major players now promoting their own RTAs, the CRTA has not tabled a report.

Are WTO constraints on RTAs appropriate?

At a conceptual level, RTAs that involve the preferential reduction of tariffs among members may be either good or bad for members and for third parties. They have several offsetting effects. The exchange of tariff preferences may generate new trade, to the benefit of members and their trading partners. It may also divert trade from more efficient third-party producers to less efficient RTA members, to the detriment of both members and third parties.

In general, which effect dominates is an empirical question, although trade preferences granted by countries such as Australia have the potential to generate solely or mainly trade diversion, and thus to be harmful.⁵

The WTO rules currently require that, when RTAs involving developed country members are formed, trade barriers:

- be eliminated (not just lowered) on ‘substantially all trade’ among members; and
- not be raised against third parties.

Developed countries are allowed to grant one-way tariff preferences to developing countries, and two or more developing countries may exchange two-way preferences. Thus the rules are considerably less stringent for developing than for developed countries.

Of the more than 200 RTAs that have been notified to the GATT/WTO, only one has been endorsed as meeting the WTO requirements (the Czech-Slovak agreement). No decision has been reached on the rest, despite some of them clearly violating the spirit of the requirements. The key problem is that the letter of the requirements does not exist. The key terms are simply not defined — neither the term ‘substantially all trade’, nor the ‘[duties and] other regulations of commerce’ that should not be raised against third countries. Assessments of individual RTAs have been hamstrung by the sequential nature of the assessments, with few member countries willing to ‘be the first’ to challenge or endorse the terms of RTAs of other members. Discussions on how to strengthen the rules have been characterised by disagreements over whether to define the terms in qualitative or quantitative ways.

It is in Australia’s interests to see WTO rules adopted and enforced that would prevent the formation of RTAs that would harm Australia, whether as a participant or as a third party, or in a systemic sense. The economics of RTAs suggest that, for Australia to gain from joining one, its coverage would have to include agricultural products. The chances of Australia successfully negotiating such an RTA with a major trading partner do not appear strong (box 3.2).

How to strengthen the WTO rules to ensure this remains problematic. Given that the process of regionalism has gone as far as it has (box 3.1), it will be difficult to constrain RTAs quickly, irrespective of the merits of RTAs taken either individually or in aggregate. Further, the current sequential process of evaluating RTAs by the WTO’s CTRA appears to have degenerated into a legalistic logjam (Laird 1999).

⁵ Panagariya (1999) points out that if a small open economy grants tariff preferences to a partner whose producers ‘price up’ to world levels, the arrangement will be trade-diverting, hence harmful. A key component of the loss would be the transfer of what was tariff revenue to producers in the preferential partner country.

Box 3.2 Australia's prospects for negotiating worthwhile RTAs

Australia has the CER with New Zealand, considered the purest regional free trade agreement to date when reviewed by the GATT.

Australia does not have any other obvious partners in a larger group. Evidently, the AFTA-CER proposal has political problems, for the time being at least. It is doubtful whether an arrangement with Japan-Korea would go beyond trade facilitation (eg, international standards, competition policy, etc.) because these countries are unwilling to consider including agriculture.

A free trade area with the United States has been analysed several times, but for Australia to benefit would require major changes in US agricultural protection, which seems unlikely even if a US Administration showed interest in a free trade agreement (Snape 1986, Snape et al. 1993). Even so, many small economies have established or are considering bilateral free trade with major players in 'hub and spoke' arrangements, where the hub has all the bargaining power and terms can be stringent. An arrangement for Australia with the United States would fit this pattern.

Of course, the major gains from trade arise from unilateral liberalisation and, with a few notable exceptions, Australia has obtained most of those since 1988.

The Commission will explore the effects of RTAs in more detail in a forthcoming staff research paper (McGuire, Adams and Gali 2001).

Laird (1999) suggests that the current schedule of evaluations be expedited, not in the expectation of definitive outcomes, but simply to clear the way for non-legal (and therefore less threatening) but broader evaluations along the lines of those in the Trade Policy Review Mechanism. Such reviews, he suggests, would aid transparency and also yield the sort of information needed for effective definitions of the terms currently embodied in the relevant WTO provisions (in GATT Article XXIV and GATS Article V).

Others have suggested amending the WTO rules to guard against the formation of harmful RTAs. For example:

- Panagariya (1999) suggests that members forming RTAs be required to bind their non-preferential tariffs at actual levels prevailing at the time of negotiation. This would mean that members could not subsequently raise tariffs against third parties without also violating one of the more fundamental rules of the WTO — the requirement not to raise tariffs above bound levels.
- Panagariya (1999) also suggests that RTA members be required to extend their tariff preferences to all WTO members according to a fixed schedule, say five or ten years after the formation of the RTA.
- Bhagwati and Krueger (1995) have argued that RTAs should be restricted to customs unions (common external tariff) to avoid trade deflection and complex rules of origin which impede trade.

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- Bhagwati and Krueger (1995) have also argued that each member country should be restricted to one customs union, to prevent discrimination using ‘hub and spoke’ arrangements, while customs unions should be open for any country to join if it can accept the conditions of the treaty.
 - Snape et al. suggested that RTAs, as well as being required to strictly follow the rules of the WTO, should be open for new members to join, on the same basis that existing members joined (Snape, Adams and Morgan 1993; Snape 1996)

In the Commission’s view, the relevant WTO provisions ideally should be reviewed as part of a new round, the aim being to make them more consistent with the spirit of open multilateralism. Such a review would need to clarify the key terms in the provisions, as well as considering other proposals such as those set out above.

On the other hand, if a ‘cooling off’ period is required, immediate agreement on such measures would not be forthcoming. In this case, the Commission assesses that Laird’s suggestion of a comprehensive review mechanism would be a useful first step.

Nevertheless, an important safeguard against the formation of harmful RTAs would be the successful conclusion of a new trade round, since the chances of trade diversion are reduced as general trade barriers fall.

Impacts of new RTAs on the WTO system

The second key question is whether the current proliferation of RTAs poses a threat to the successful conclusion of a new multilateral trade round.

Several features of the new RTAs being proposed offer cause for concern. An example is the proposed Japan-Singapore RTA, which would appear not to be a conventional trade agreement at all. Japan, which has hitherto been one of the staunchest defenders of a multilateral approach to trade liberalisation, has chosen Singapore as its first RTA partner, precisely because substantially all merchandise trade between the two countries is already effectively free. Not coincidentally, agricultural trade between the two is minimal. Instead, the proposed trade agreement focuses on attempts to reform ‘new age’ areas such as services, investment, inter-government cooperation and e-commerce.

The danger would lie in generalising this model to partners with which merchandise trade was not already substantially free. While it might look superficially appealing for ‘new age trade agreements’ to concentrate on new age issues, leaving the remaining areas of high trade protection to be negotiated down in a multilateral trade round, this creates the problem of ‘cherry-picking’. One of the reasons that the

Uruguay Round was concluded at all was that it dealt with trade protection in a range of areas as a ‘single undertaking’ or package. Different countries could choose to live with components that they did not see as being in the interests of key constituents (eg agriculture), for the sake of securing those components that they saw as being more so. If a comprehensive WTO round were left with a trade agenda seen as difficult by all parties, the chances of successful conclusion would be reduced accordingly.

Thus, as it enters a new round of multilateral trade negotiations, Australia needs to guard against entering RTAs that contain extensive exclusions for sensitive sectors, for three reasons:

- such agreements would violate existing WTO rules;
- they would likely not be in our economic interests; and
- by cherry-picking, they could undermine the chances of a successful conclusion to the multilateral trade round.

In any case, GATS Article VII already provides scope for some ‘new age’ trade issues to be dealt with effectively, without the need for an RTA. Specifically, Article VII allows countries to engage in the bilateral harmonisation of standards and certification requirements, provided they do so in a manner that does not discriminate against other member countries and is not a disguised restriction on trade in services. Importantly, this agreement also provides that, where two or more countries have agreed to ‘recognise’ each others’ standards or certification processes as acceptable in their domestic markets, other member countries can gain access to their markets on equivalent terms.

Another related area for concern for Australia is the tendency for large trading partners such as the United States and Japan to exercise their negotiating power in bilateral or multilateral forums in a way that would be greatly circumscribed in a multilateral context. For example, the United States has succeeded in including provisions relating to the environment and labour standards in its bilateral trade agreement with Jordan — which follow similar ‘side-agreements’ in NAFTA — at a time when WTO members are far from agreeing that such provisions belong in trade agreements at all. The United States has not yet ratified its agreement with Jordan. If it does, it will be able to use the agreement as a precedent for other potential bilateral trade partners. Clearly, to maintain its integrity in international forums, Australia needs to guard against acquiescing to provisions in a bilateral or plurilateral context that for good reasons it does not favour multilaterally.

3.2 Environment and labour issues

DFAT has invited comment on whether Australia should support negotiations or further study within the WTO on whether environmental standards should be ‘linked’ to trade agreements. This issue has been debated extensively in public and in the literature. The impacts are complex. For example, some environmentalists argue that the growth-generating effects of trade harm the environment, while WTO agreements undermine global environmental policies. But some trade policy practitioners maintain that including environmental issues in the WTO would undermine the multilateral trading system which, in turn, would reduce the growth necessary for governments to be able to address modern environmental problems, particularly in developing countries. They also point to certain trade liberalisation reforms that could directly benefit the environment.

Although the list of topics mentioned in the DFAT Request for Public Comment is open ended, labour issues are not specifically mentioned. Yet there has been much debate in recent years about the effects of trade on wages and working conditions and on the merits of linking ‘core’ labour standards to trade agreements. At the First WTO Ministerial Council Meeting in Singapore in 1996, member countries declared:

We renew our commitment to the observance of internationally recognised core labour standards. The International Labour Organisation (ILO) is the competent body to set and deal with these standards, and we affirm our support for its work in promoting them. We believe that economic growth and development fostered by increased trade and further trade liberalisation contribute to the promotion of these standards. We reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no-way be put in question. In this regard, we note the WTO and the ILO Secretariats will continue their existing collaboration.

At Seattle, some developed countries sought to place ‘core’ labour standards on the WTO agenda, and this was one reason why the Ministerial Meeting failed. While there appears to be general agreement among member governments that labour issues will not be considered at Qatar, there are indications that these issues could arise again in the future, especially given the structure of the United States Congress and apparent moves by US business groups to accept linkage (Hartcher 2001).

A forthcoming staff working paper (Nankivell 2001) explores the links between trade and both environmental and labour standards. The following assessment draws on that work, and the references cited therein.

Trade and the environment

Environmental problems are not caused by trade itself, but rather by *any form of economic activity where environmental policies are deficient*. International trade is not intrinsically different from any other form of commerce: it simply involves crossing a line on a map. What matters is not whether international trade occurs, but rather whether the environmental policies applying to any form of commerce — domestic or international — are appropriate.

Trade sanctions are a blunt instrument for addressing environmental problems. Measures such as environmental standards, subsidies or charges, that directly address the source of the problem, will normally be better ways of achieving environmental objectives.

Further, many environmental problems are not inherently international in scope. For example, two of Australia's biggest environmental problems, salinity and land degradation, involve only domestic issues. Domestic policies, which can be varied to meet specific local needs and conditions, are the appropriate instrument for dealing with such problems.

While trade sanctions are a poor means of addressing environmental issues, some trade liberalisation policies would clearly assist the environment. First, the removal of trade-distorting subsidies to some sectors, such as agriculture, forestry, fisheries and energy, would reduce the rate of resource use by those sectors. Second, trade can help to create and diffuse new technology, which has an important role to play in improving environmental outcomes. Indeed, while advocating reforms to certain aspects of the WTO system, the Australian Conservation Foundation (1999) has stated that:

... trade and investment liberalisation could assist moves towards ecologically sustainable societies. An example is the opening up of markets for efficient, less polluting goods and production technologies and services, while restricting ecologically unsustainable rates of resources exploitation and pollution.

More generally, by promoting a more efficient pattern of global production, trade liberalisation can reduce the level of resources necessary to sustain a given level of global production. And the higher income levels that trade helps to sustain can provide governments with the resources, and community support, to address environmental issues, particularly in developing countries. Meanwhile, the evidence of a 'race to the bottom' in environmental standards, as feared by some environmentalists, is weak (Nordström and Vaughan 1999).

In some specific cases, the non-discriminatory nature of WTO agreements can constrain the ways in which environmental objectives can be pursued. Specifically, WTO rules:

- constrain governments in setting ‘unscientific’ environmental standards within their own borders, lest they be used as covert trade barriers;
- limit the extent to which governments can discriminate among imports according to methods of production, including environmentally unsustainable production processes, to reduce the scope for protectionist abuse; and
- limit the extent to which governments can act unilaterally through trade against what they see as environmentally unsustainable practices abroad, but in so doing may also constrain the use of trade sanctions in multilateral environmental agreements.

The WTO rules are about trade relations and, while constraining environmental policy makers to a degree, it is not clear that the balance struck is inappropriate from the view of overall community welfare. Further, there is a significant risk that moves to modify the WTO agreements could open the door to protectionist abuse. Developing countries in particular have indicated their opposition to environmental policies linked to trade agreements, with future trade negotiations potentially at risk.

The Commission’s assessment is that the Australian Government should maintain a watching brief but that, at this stage, it should not support proposals to link environmental standards to WTO agreements.

Trade and labour standards

The labour standards debate centres around proposals to embody ILO ‘core’ labour standards in WTO agreements, such that a country’s failure to observe core standards — rights of association and collective bargaining, and bans on discrimination, slavery and child labour — would be grounds for other countries to impose trade sanctions upon it.

The grounds for seeking to enforce core standards with trade sanctions are weak, for three main reasons.

- First, although such a link might improve compliance with core standards in the export sectors of developing countries, it would not affect most workers, the vast bulk of whom work in the informal and domestic sectors of developing economies. Further, efforts to enforce compliance with some core standards have, in the past, left some workers without jobs and in a more serious plight (Hansenne 1998). Consequently, other options would be more effective. For

example, further trade liberalisation through the WTO, coupled with financial and technical assistance for developing countries, is more likely to alleviate poverty and lift living standards in developing countries.

- Second, this link raises significant national sovereignty concerns for developing nations. Some see labour standards proposals as an attempt to impose first world standards on third world countries, or as ‘thinly veiled protectionism’. Others argue that a country’s labour standards are a matter for the country itself to determine, because the employment conditions within a country do not directly affect people in other countries.
- Third, whatever the merits of developing countries’ concerns, it is clear that simply raising the labour standards issue within the WTO has the potential to derail trade negotiations. Given that further trade liberalisation could do much to alleviate poverty and raise living standards in developing countries, it could also end up being counterproductive to the humanitarian concerns that underlie proposals to link core labour standards to WTO agreements.

The Commission considers that proposals to link core labour standards to WTO agreements do not warrant support. Among other things, this reflects the risks and likely ineffectiveness of using trade sanctions to enforce core standards, and a view that pursuing other options would be more likely to alleviate poverty and generate higher living standards in developing countries. This is not to say that compliance (where appropriate) with the ILO’s core standards should not be encouraged. However, this should remain a matter for the country concerned, together with the ILO.

3.3 Contingent protection

The GATT contains three articles which allow countries to derogate from their other WTO commitments in certain circumstances, to provide ‘contingent protection’ for domestic industries suffering damage from import competition. The three articles cover:

- Safeguards against import surges (Article XIX);
- Anti-dumping (Article VI); and
- Subsidies and Countervailing Measures (Article XVI).

The articles effectively are the GATT’s ‘escape clauses’ for countries wanting to protect domestic industries from import competition under defined conditions. Their inclusion in the GATT reflects the balancing of interests that has occurred over time through GATT/WTO negotiations.

All three articles were reviewed in the Uruguay Round negotiations and ‘modernised’ to deal with their uses in the liberalised trading system.

Notwithstanding the changes, these articles remain a source of tension, particularly between developed and developing countries. This is because the developed countries frequently resort to one or other of these instruments whenever imports from developing countries become too competitive. On the other hand, many OECD countries see them as a useful safety valve to deal with domestic protectionist pressures.

Safeguards against import surges

GATT Article XIX was extended into a new agreement on safeguards (Annex I of the Marrakesh Agreement). The new agreement allows for safeguard action against imports of particular products which are deemed to be causing, or threatening to cause, serious injury to an industry. Safeguard action is intended to provide temporary assistance to enable industries to adjust to increased competition from imports.

OECD governments had been unwilling to use the previous agreement to overcome ‘competitive import surges’ from particular countries, because safeguard measures were required to be non-discriminatory as well as temporary. As a result, importing countries had opted instead for bilaterally negotiated ‘voluntary’ *export* restraints (VERs) to control imports. These measures were often formally implemented or imposed by industry bodies, rather than governments as such, so as to avoid a technical breach of GATT rules. They were generally more acceptable to both the importing and exporting country than the alternative — non-discriminatory import quotas.

The new safeguards agreement establishes a framework to remove pre-existing VERs gradually, as well as setting out the conditions where temporary protection is allowed. A key requirement in the new agreement — highlighted in the Commission’s report on the Australian pigmeat industry (PC 1998) — is that safeguard action should include transition measures which facilitate adjustment by the affected domestic industry. The new agreement also provides for safeguard measures to be actionable under the WTO’s strengthened dispute settlement process. Indeed, Australia was recently successful in an action against safeguard measures imposed by the United States to protect its lamb industry.

Notwithstanding these changes, a number of developing countries remain concerned about the safeguards agreement, believing for example that the new agreement will be used by industrial countries to replace trade restrictions in textiles and clothing,

as implementation of the Uruguay agreement on textiles and clothing (ATC) moves into its final phase.⁶ Australia should emphasise the need for safeguard measures to ‘facilitate change’ in any negotiations.

Anti-dumping

GATT Article VI allows member countries to apply restrictive measures on ‘dumped’ imports if they cause, or threaten to cause, material injury to a domestic industry. Under Article VI, dumping occurs when a foreign supplier exports goods at a price below the ‘normal value’ of the goods in the supplier’s home market, but there is no single definition of normal value in Article VI. The good’s price in the exporter’s home market is generally used to determine the normal value, but alternatives such as the good’s price in another export market, or a constructed price, are sometimes used instead. Further, anti-dumping measures are not readily challengeable under the WTO dispute settlement process. Hence, member governments are provided with significant discretion in their application of anti-dumping measures.

Intense negotiations on anti-dumping in the Uruguay Round failed to achieve significant restraints on the freedom of countries to invoke GATT Article VI. In the past five years, the number of anti-dumping cases has burgeoned as many non-OECD countries have introduced anti-dumping legislation.

In relation to anti-dumping provisions, Stoeckel (2000, 42) has stated:

Another obvious change required is in the way the WTO applies anti-dumping rules. The WTO examines only one side of the equation — the injury caused [by dumping]. Even then ‘injury’ is examined in a very narrow technical way. The economic costs as well as the benefits should be examined. By looking at the costs, the argument is biased towards protection. Little wonder that anti-dumping claims are rising.

Subsidies and countervailing measures

Under GATT Article XVI, member countries may apply countervailing duties where imports, benefiting from certain forms of subsidies in the country of origin, cause or threaten to cause material injury to a domestic industry.

⁶ The spread of ‘safeguarding’ protection against imports of textiles and clothing from non-OECD countries resulted in the complex regime of price controls and quotas that formed the multifibre agreement (MFA) which controlled this trade for 30 years. The agreement on textiles and clothing (ATC) is intended to phase out the MFA restrictions by the end of 2004, but many developing countries expect that ‘the safeguards complex’ will be used to maintain protection in OECD countries (although the use of anti-dumping measures, discussed below, presents a more obvious risk).

The Uruguay Round Agreement on Subsidies and Countervailing Measures (SCM) achieved notable advances. It expanded the list of prohibited subsidies, strengthened disciplines on subsidies and clarified rules for action against other countries' subsidies. The SCM Agreement defines subsidies and allows (limited) exceptions for subsidies to protect the environment, to encourage regional development, and for research and development. It has reduced the use of non-agricultural subsidies substantially. (Agriculture subsidies are covered by the Agreement on Agriculture.)

Should contingent protection be reviewed in a new round?

The contingent protection provisions provide an avenue for importing countries to introduce protection against perceived 'unfair' competition or increased imports that damage domestic industries. As long as the decisions are left to individual governments to decide whether imports represent 'unfair' competition, the effects on trade have the potential to be arbitrary and distorting. Safeguards and subsidies are subject to consultations and appeal within the WTO system, but anti-dumping remains a decision by the importing country authorities, with few external restraints.

Although opposition to any additional restraints on anti-dumping actions is strong, the issue should be on the agenda for the new round. Australia should have had the opportunity to conduct an independent public review of its own arrangements, under the National Competition Policy legislative review program, before the round has progressed far. Experience since the Uruguay Round shows there are gaps to be filled in the arrangements for each of these forms of contingent protection. The process for economic review in the new safeguards agreement offers opportunity for public participation. The Carmichael/Duncan proposal is compatible with the strengthening of the GATT's safeguard provisions.

3.4 Risk analysis for quarantine measures

Quarantine measures, which are necessary to protect the health of animals and plants from disease and pest risks introduced by imports, must conform with the 1995 WTO Agreement on Sanitary and Phytosanitary Measures (SPS Agreement).

The Agreement provides the governments of WTO members with rights to introduce a 'sanitary or phytosanitary' (SPS) measure and to determine their own 'appropriate level of protection' (or 'acceptable level of risk').⁷ In exercising these rights, however, member governments must meet various obligations (box 3.3).

⁷ The appropriate level of protection is effectively a desired risk target or objective.

Box 3.3 Key obligations under the SPS Agreement

- WTO members governments must ensure that a measure applies only to the 'extent necessary' to protect human, animal or plant life or health, is based on 'scientific principles' and is not maintained without 'sufficient scientific evidence'. (article 2.2)
- Members must ensure that a measure does not 'arbitrarily or unjustifiably discriminate' between members where identical or similar conditions prevail and must not be a 'disguised restriction' on international trade. (article 2.3)
- Members must ensure that a measure is based on an assessment of the risks to human, animal or plant life or health, taking into account techniques developed by relevant international organisations. (article 5.1)
- In determining the appropriate level of protection, members must take into account the objective of minimizing negative trade effects. (article 5.4)
- In determining the appropriate level of protection, members must avoid arbitrary and unjustifiable distinctions in the levels it considers to be appropriate in different situations if such distinctions result in discrimination or a disguised restriction on international trade. (article 5.5)
- In determining the measure to be applied for achieving the appropriate level of protection, members must take into account relevant economic factors including the 'relative cost-effectiveness of alternative approaches to limiting risks'. (article 5.3)

Two questions about the SPS Agreement are relevant at this time:

- the current analytical approach to determining quarantine measures; and
- the role of the precautionary principle, when scientific information about risks is limited or absent.

The current analytical approach

In determining quarantine measures in a manner consistent with the SPS Agreement, member countries generally undertake import risk analyses (IRAs). An IRA is a scientific assessment of risk that determines the quarantine measures necessary to reduce the assessed risk to a level consistent with a member country's appropriate level of protection.

The role of economic analysis in the determination of quarantine measures is limited; at best, a cost-effectiveness analysis could be applied (Binder 2001, forthcoming staff research paper). It has been argued by quarantine regulators that this is an intended outcome of the SPS Agreement.

There is scope to introduce greater consistency in how members undertake IRAs. First, they could define precisely their appropriate level of protection. At present the concept tends to be expressed in vague terms. Second, members could apply cost-effectiveness analysis in their choice of quarantine measures and, in doing so, consider explicitly the costs that different measures impose, not only domestically but also on exporting countries.

Such improvements could be encouraged within the current SPS Agreement and by the SPS Committee. The Agreement has now been in operation for five years. The SPS Committee could review different countries application of IRAs in practice, including how they identify their appropriate levels of protection and the domestic and external cost impacts of quarantine measures. Such a review would provide information to help members to improve their current compliance as well as to encourage their adoption of quarantine measures which are least-trade restrictive.

The precautionary principle

A second issue is whether the SPS Agreement allows an ‘appropriate’ treatment of precaution where there are unknown or poorly understood risks. Article 5.7 of the SPS Agreement provides that where relevant scientific evidence is insufficient, a member government may provisionally adopt a measure on the basis of ‘available pertinent information’. But if it does so, it must seek additional scientific information necessary for a ‘more objective’ assessment of risk and review the measure within a ‘reasonable period of time’.

The role of the precautionary principle in relation to the SPS Agreement has been raised particularly by the European Communities. In its ‘comprehensive negotiating proposal’ to the WTO Committee on Agriculture, the EC submitted:

There is public concern that the WTO could be used to force onto the market products about whose safety there are legitimate concerns. However, WTO Members can address these concerns through appropriate measures, including the use of the precautionary principle, provided that these measures are proportionate to the risk and applied in a non-discriminatory way, and do not give rise to disguised restrictions to trade. Nevertheless, some Members are still concerned about the way in which the precautionary principle might be implemented. To this end, the EC, therefore, propose that the application of the precautionary principle should be clarified (EC 2000a, 4).

There is no international consensus on the precautionary principle. For example, Byron (2001, 29) notes that, compared with the precautionary approach expressed in the 1992 Rio Declaration⁸, the precautionary principle as promoted more recently by the European Commission⁹ appears ‘to authorize and legitimize governments taking action without due cause, reversing the onus and direction of action.’ Both

versions are worded more strongly, and imply less need for evidential support for environmental standards, than the SPS Agreement.

Where a liberal approach to precaution is taken, there is scope for resultant trade measures to be unduly restrictive, potentially opening the door to protection. For example, a Commission analysis (PC 2000d) found the Cartagena Protocol's approach to precaution could result in import restrictions on genetically modified organisms which could *unnecessarily* delay or even permanently deny producers and consumers the benefits of opportunities to improve productivity and outputs. Although a degree of precaution is appropriate, the Protocol fails, among other things, to require sensible measures to reduce scientific uncertainty progressively.

While there is scope for further clarification to be given by the SPS Committee on the appropriate implementation of Article 5.7, changes that would weaken the current obligations within the SPS Agreement, including the disciplines under Article 5.7, would have potentially adverse affects on Australia's interests, particularly with respect to agricultural exports. In the absence of an international consensus on the precautionary principle, proposals to introduce it into the SPS Agreement could destabilise trade negotiations.

Australia's negotiating position

There may be a case for Australia to extend its evaluation of costs and benefits of quarantine measures on imports beyond the current IRA/cost-effectiveness approach (Binder 2001), but if exposed in the WTO, this process would open opportunities for other members to raise their barriers against agricultural imports on spurious grounds. It would be preferable to clarify the existing SPS agreement rather than to allow negotiations to expand it beyond its current scientific basis, or to incorporate the precautionary principle.

⁸ The Rio Declaration on Environment and Development states that '...in order to protect the environment, the precautionary approach shall be widely applied by states in accordance with 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' (United Nations 1992, cited in Byron 2001).

⁹ A concise definition used recently by the European Commission reads: 'The precautionary principle is an approach to risk management that is applied in circumstances of scientific uncertainty, reflecting the need to take action in the face of potentially serious risks, without awaiting the results of scientific research' (EC 1998, cited in Byron 2001). In February 2000, the European Commission released a more extensive 'Communication on the precautionary principle' which recognises, among other things, that 'In some cases, the right answer [scientific uncertainty and community concerns about risks] may be not to act or at least not to introduce a binding legal measure' (EC 2000b, cited in Robertson and Kellow 2001, 250).

3.5 International arrangements for foreign investment

Recently, Commission staff completed a working paper on international treaties applying to foreign investment flows (Binder, Papadimitriou and Monday 2001). Among other things, the paper suggests that there may be deficiencies in the GATS. It also suggests that any future round of multilateral trade negotiations within the WTO would present an opportunity to examine reform options. Its key points are summarised below.

- There are at least 1850 bilateral investment treaties, about 50 regional/plurilateral arrangements and at least 20 multilateral agreements and voluntary guidelines that apply to foreign investment.
- The OECD, WTO, UNCTAD and the World Bank continue to discuss these international arrangements and to consider the need for strengthening the international rules covering foreign investment.
- From an efficiency perspective, some ‘desirable features’ include:
 - a broad investment focus;
 - policy coherence;
 - unconditional non-discriminatory treatment of foreign investors;
 - adequate protection of foreign investor’s property;
 - transparency;
 - disciplines on investment incentives and performance requirements;
 - mechanisms for facilitating reform;
 - provisions to ensure that bilateral, regional and plurilateral arrangements do not undermine multilateral efforts to promote foreign investment; and
 - legally binding provisions.
- Examination of existing arrangements supports the case for further reform of international arrangements, although the most appropriate nature of reform is unclear. Multilateral negotiations would provide the most comprehensive reform, but there is no agreed basis from which to begin, as the WTO working group and OECD negotiations on the Multilateral Agreement on Investment demonstrated.
- The new round of multilateral trade negotiations offers opportunities for reform:
 - there are options within the context of mandated reviews covering WTO agreements relating to TRIMs and GATS;
 - there are options to improve WTO rules on regional trade agreements; and

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- there is a proposal to negotiate a new investment agreement (supported by Japan and the European Union).

While the first two categories offer scope for improvements to existing arrangements, the Commission considers that more preparatory work would be needed before negotiations on a new investment agreement could begin.

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