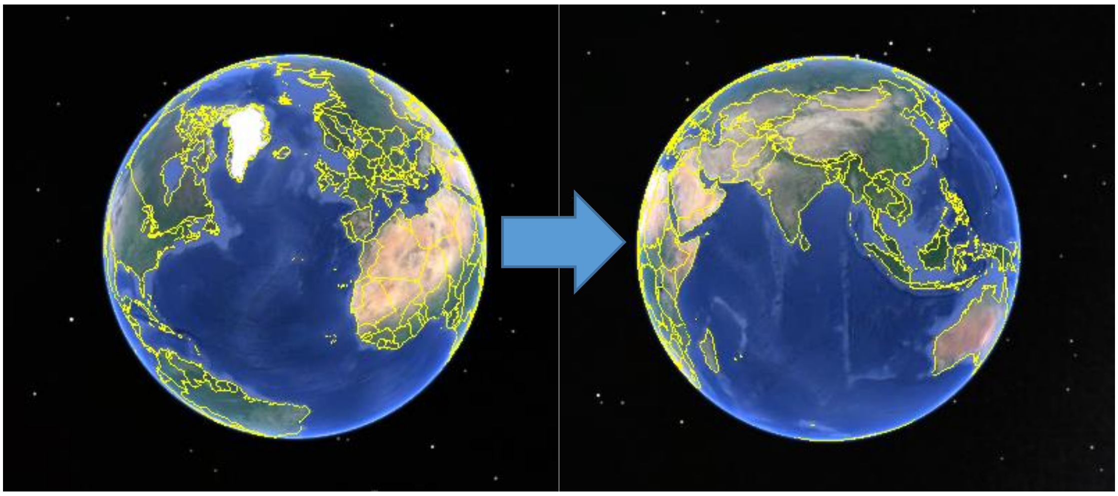
Globalisation – prismatically unfolded

International Law and Institutions shaping Globalisation



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Foreword

The present text is an excerpt of the publication “Globalisation – prismatically unfolded”. This comprehensive publication may be read in a different order due to a common structure of the single chapters. Benefitting from this aspect, in the present excerpt, the parts dealing with international law and international organisations are fused under one cover. Compared to the full text, the substantive content of the retained parts remains the same. Only a few sections were removed to make the presentation of the legal and institutional aspects more stringent than in the basic text. The single chapters appear here in a somewhat different order but agricultural market access still precedes the presentation of the rules applicable to industrial goods. FDI, services and intellectual property rights follow, reflecting the changing importance of these provisions in international law in accordance with the stage of development a country has reached. The presentation of the most important International Organisations is now concentrated at the end of the text. The present text may be read without reference to the basic document.

Table of Content

Overview

Globalisation became the dominant economic and political phenomenon in the last decade of the 20th century. The ambition of the present text is to cover most institutions and legal topics relevant for globalisation. International trade law and the WTO will be core and not the global financial institutions, however.

The single chapters cover the following topics:

- Disciplines for subsidising trade and production of agricultural goods figure prominently in the initial chapter of the text, while
- in Chapter 2 some thoughts are given to development aspects in the international agricultural trade regime.
- The extractive industries are best placed to illustrate the topic of investment protection agreements (Chapter 3).
- Free trade and other preferential agreements are the topic in Chapter 4 which concentrates on trade in textiles since, among manufactures, tariff barriers remain important for these goods.
- Chapter 5 deals with a topic that has gained enormously in prominence in recent years, namely taxation of MNEs.

Having covered with Investment Protection Agreements, Preferential Trade Agreements and Double Taxation Agreements the main forms of agreements concluded on a bilateral basis, the text continues with the presentation of additional features of the WTO.

- Chapter 6 looks at accession negotiations, anti-dumping and other safeguard measures while
- Chapter 7 sets out the legal framework for trade in services.
- Chapter 8 takes up public procurement while
- Chapters 9 covers topics in trade law that are often somewhat neglected, namely the right of transit and the Law of the Sea. Rules for transportation as set by the EU and the Energy Charter are also taken up.
- Chapter 10 presents the growing body of international legislations dealing with environmental concerns.
- Core labour standards as defined by the ILO and their enforcement are the content of Chapter 11.
- Since a certain behaviour may still be legal but no longer legitimate, Chapter 12 looks at Corporate Social Responsibility, but also at the rules imposed internationally on MNEs regarding e.g. corruption.
- The international protection of Intellectual Property Rights IPR is the topic of Chapter 13 while
- Chapter 14 addresses the question whether there is a need for a global agreement on competition.

In the last two chapters, the focus shifts from the presentation of relevant international legislation to the presentation of institutions relevant for globalisation.

- Chapter 15 contains the first half of the portraits of International Organisations (beyond the presentation of the WTO, the latter occurring in Chapter 1 and through the following chapters). In the chapter, security policy giving raise to export controls is examined in some depth.
- The second half of portraits follows in Chapter 16 where the focus is on the International Organisations relevant for financial markets. The rules for capital flows they emit and the supervision of financial markets they exercise are quickly reviewed. A section on Sovereign Wealth Funds concludes.

Chapter 1

Dismantling Agricultural Protectionism

1 The WTO

Protectionist policies ranked high in the period after the First World War (below WWI). The Great Depression, in particular, was seen as having been aggravated by the loss of export opportunities, driving countries to build up demand by investing in military equipment which then also came to use. In the aftermath of the Second World War (henceforward WWII), the errors of the prewar period should be avoided. Competitive devaluations should no longer be possible and a liberal trade regime should firmly be enshrined. With regard to competitive devaluations, the constitution of the Bretton Woods Institutions constituted the answer.[1] Negotiations were less successful with regard to trade liberalisation since no international organisation dealing specifically with trade issues could finally be established after the checkmate for the International Trade Organisation ITO in the US Congress.

For more than four decades, trade negotiations and the monitoring of the agreements concluded were then not formally harboured within an International Organisation. Trade negotiations occurred by way of periodic reforms of a comprehensive multilateral trade agreement, the General Agreement on Tariffs and Trade (GATT) concluded in 1948. The latter was anchored in Geneva, close to the United Nations establishments, where also most of the negotiations took place. As a result of the eight trade negotiating rounds since WWII, barriers to trade in industrial products were largely removed among the main trading nations; however, only minimal trade liberalization occurred in the agricultural sector. Within the GATT, enforcement and supervision also limped.

Since the GATT already disposed of a secretariat with a permanent staff of some 300 persons, the creation of the World Trade Organisation as one of the most important International Organisation in 1995 did not create a situation where completely new structures had to be built up. But the Uruguay Round of GATT within which the creation of the WTO was a major topic added substantive other elements to the global framework of trading rules. Consequently, the Marrakesh Agreement concluding the Uruguay Round had to provide a legal framework for an international organisation with responsibilities extending far beyond the one's of the predecessor organisation, the GATT and its secretariat. In fact, the latter concentrated on tariffs and other aspects of goods trade. The WTO additionally assumes responsibilities in services and intellectual property rights, to mention just the two most important extensions of GATT in the Uruguay Round.

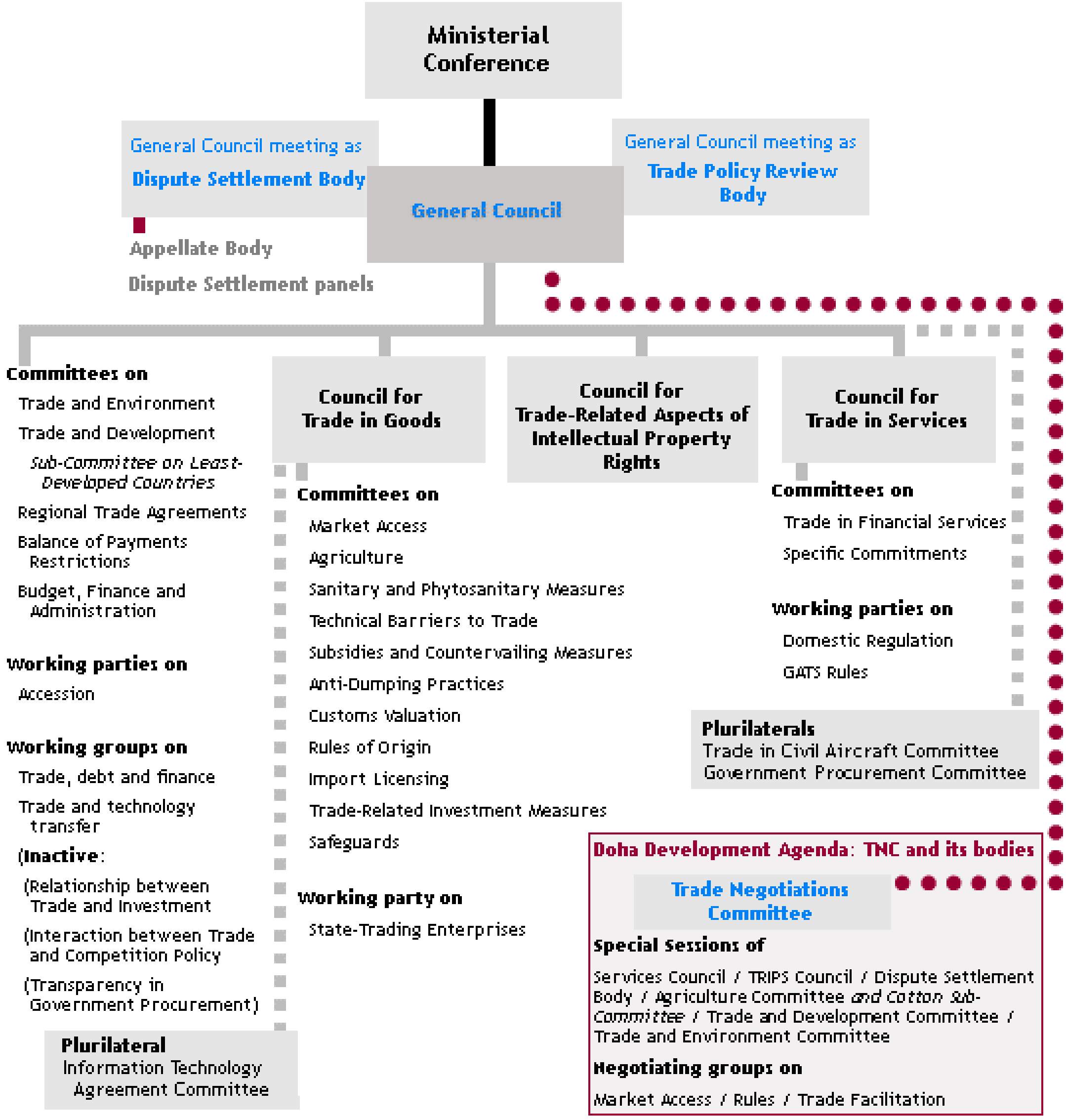
These extended responsibilities become apparent in the organisation's organigram reproduced below.[2] Additional to the Council for Trade in Goods which handles the subsisting GATT agreement there is a Council for Trade related Aspects of Intellectual Property Rights, handling the TRIPS agreement, and a Council for Trade in Services, handling the GATS agreement. Of primary importance is also an entry at the top of the diagram entitled "General Council meeting as Dispute Settlement Body". This entry expresses that, different to the GATT, the treaties concluded or reformed by the Marrakesh Agreement dispose of enforcement mechanisms of remarkable vigour. The box on the right, entitled General Council meeting as Trade Policy Review Body reflects a new instrument that had been given to the WTO, namely periodical reviews of member states trade relevant policies.

The box in the lower right corner reflects that the reform of the international trade agreements continues to be organised in negotiating rounds. The Doha Development Round was started in 2001 but has since not come to a conclusion. The box indicates how member countries formally proceed in these negotiations. On one hand, the Councils, Committees and Working

[1] As indicated above, International Organisations with a focus on financial market are covered in Chapter 16 at the very end of the book.

[2] The organisational chart – as other information in this section –are taken from the homepage of the WTO. The chart specifically may be found at : https://www.wto.org/english/thewto_e/whatis_e/tif_e/org2_e.htm

Groups meet in special sessions, on the other hand particular negotiating fora had been constituted, one on market access (subdivided in access to markets for agricultural goods and access to non-agricultural markets (NAMA)), one on rules and one on trade facilitation. The latter topic is the only one of the Singapore issues[3] that came to a conclusion. So, since 2015, this negotiating group is no longer called in.



The other three Singapore issues appear in the lower left corner of the graph. Inactive are the working groups on competition and investment and a stalemate also exists with regard to more transparency in public procurement. However, in the latter case, one of the three entries under the title "Plurilaterals" is of importance. In fact, the WTO hosts the Government Procurement Agreement. Opposite to the GATT, the GATS and the TRIPS agreement where the rights laid down in these treaties have to be granted uniformly to all other WTO members, the rights laid down in the three plurilateral agreements (the other two refer to information technology (lower left) and aviation) accrue only to the parties of these specific agreements.

In the column in the left appears that the WTO is sensitive to the tensions that exist between free trade at the global level and other public concerns, in particular environment, development, regional economic integration and macro-economic imbalances, the latter possibly leading to balance of payment restrictions. While Committees are con-

[3] At the WTO's Ministerial Conference in December 1996 in Singapore, it was considered to add to the Doha Development Round trade facilitation, competition, investment and procurement as themes for negotiations (beyond - as already agreed in Marrakesh - continued agricultural negotiations).

stituted to handle interrelations which are considered to constitute challenges of a permanent nature, working groups or parties are constituted to handle issues that may possibly be settled after some years. This is currently the case with accession, indebtedness of parts of the world and technology transfer. Committees and Working Groups exist also under the auspices of two of the three Councils. In the case of services, they deal with financial services and consider that trade liberalisation is more directly linked to reform of domestic markets than this is the case when goods trade is liberalised. With regard to the Committees and the Working Party reporting to the Council for Trade in Goods, the following chapters will offer an opportunity to present in more detail the aspects of the GATT agreement which are discussed therein.

Formally established on 1 January 1995, the WTO had on 30 November 2015 162 countries as members. The Secretariat continued to be located in the buildings of the GATT in Geneva, Switzerland, and has currently a staff of some 650 persons. The organisation's budget is some US-$ 200mio. Roberto Azevêdo heads as Director-General the Secretariat. He is a former ambassador of Brazil to the WTO and was in this capacity deeply involved in the litigious case on cotton that had been brought to the Dispute Settlement Body against subsidies for cotton producers granted in the US (see below in this chapter). In accordance with what we have described above, the Secretariat names as its functions i) to administer WTO trade agreements, ii) to constitute a forum for trade negotiations, iii) to handle trade disputes and iv) to monitor national trade policies, but also v) to provide technical assistance and training for developing countries and vi) to cooperate with other international organizations.

The WTO continues GATT's tradition of making decisions not by voting but by consensus. This allows all members to ensure their interests are properly considered even though, on occasion, they may decide to join a consensus in the overall interests of the multilateral trading system. Where consensus is not possible, the WTO agreement allows for voting — a vote being won with a majority of the votes cast and on the basis of "one country, one vote". The WTO is run by its member governments. All major decisions are made by the membership as a whole, either by ministers (who meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva).

In negotiations about shaping and adopting new international trade rules, important breakthroughs are rarely made in formal meetings of the negotiating bodies, least of all in the higher level councils. Since decisions are made by consensus, without voting, informal consultations within the WTO play a vital role in bringing a vastly diverse membership round to an agreement. One step away from the formal meetings are informal meetings that still include the full membership, such as those of the Heads of Delegations (HOD). More difficult issues have to be thrashed out in smaller groups. A common recent practice is for the chairperson of a negotiating group to attempt to forge a compromise by holding consultations with delegations individually, in twos or threes, or in groups of 20-30 of the most interested delegations. These smaller meetings have to be handled sensitively. The key is to ensure that everyone is kept informed about what is going on (the process must be "transparent") even if they are not in a particular consultation or meeting, and that they have an opportunity to participate or provide input (it must be "inclusive").

Some groupings in the ongoing Doha Round negotiations have acquired a more permanent status and are not only forged to coordinate allies with regard to particularly litigious questions in ongoing negotiations. They became known as G-X groups, X reflecting the number of their members, and are composed as indicated in the table below. There are also G-X fora which have nothing to do with the WTO (such as the G-7). These will be presented in Chapter 16.

One informal forum has become controversial, but more among some outside observers than among delegations.[4] The "Green Room" is a designation taken from the informal name of the director-general's conference room. It is used to refer to meetings of 20–40 delegations, usually at the level of heads of delegations. These meetings can take place elsewhere, such as at Ministerial Conferences, and can be called by the minister chairing the conference as well as the director-general. Similar smaller group consultations can be organized by the chairs of committees negotiating individual subjects, although the term Green Room is not usually used for these. In the past delegations have sometimes felt that Green Room meetings could lead to compromises being struck behind their backs. So, extra efforts are made to ensure that the process is handled correctly, with regular reports back to the full membership. As indicated by the table below, in order to increase

[4] The following text is taken from http://www.wto.org/english/thewto_e/coher_e/wto_un_e.htm and reflects therefore the organisation's view and experience.

their bargaining power, countries have formed coalitions, and this helps somewhat in assuring even treatment. In some subjects such as agriculture virtually all countries are members of at least one coalition — and in many cases, several coalitions. This means that all countries can be represented in the process if the coordinators of the coalitions and other key players are present in the key informal meetings. The coordinators therefore take considerable responsibility for both "transparency" and "inclusiveness" by keeping their coalitions informed and by taking the positions negotiated within their alliances. In the end, decisions have to be taken by all members and by consensus. The membership as a whole would resist attempts to impose the will of a small group. No one has been able to find an alternative way of

G-10	Coalition of countries lobbying for agriculture to be treated as diverse and special because of non-trade concerns (not to be confused with the Group of Ten Central Bankers) **Issues:** Agriculture	**WTO members (9):** Chinese Taipei, Iceland, Israel, Japan, Korea, Liechtenstein, Mauritius, Norway, Switzerland
G-20	Coalition of developing countries pressing for ambitious reforms of agriculture in developed countries with some flexibility for developing countries (not to be confused with the G-20 group of finance ministers and central bank governors, and its recent summit meetings) **Issues:** Agriculture	**WTO members (23):** Argentina, Bolivia, Brazil, Chile, China, Cuba, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, Philippines, South Africa, Tanzania, Thailand, Uruguay, Venezuela, Zimbabwe
G-33	Also called "Friends of Special Products" in agriculture. Coalition of developing countries pressing for flexibility for developing countries to undertake limited market opening in agriculture **Issues:** Agriculture	
G-90	African Group + ACP + least-developed countries **Issues:** General	

achieving consensus on difficult issues, because it is virtually impossible for members to change their positions in meetings of the full membership with in-avoidable media coverage.

Market access negotiations also involve small groups, but for a completely different reason. The final outcome is a multilateral package of individual countries' commitments, but those commitments are the result of numerous bilateral, informal bargaining sessions, which depend on individual countries' interests (examples include the traditional tariff negotiations, and market access talks in services.)

If informal consultations in various forms play a vital role in allowing consensus to be reached, the formal meetings often focus on exchanging views, putting countries' positions on the record, and ultimately on confirming the comprises found in the informal meetings.

Although the WTO is not a UN specialized agency,[5] it has maintained strong relations with the UN and its agencies since its establishment. The WTO-UN relations are governed by the "Arrangements for Effective Cooperation with other Intergovernmental Organizations-Relations between the WTO and the United Nations" signed on 15 November 1995. The WTO Director General participates to the Chief Executive Board CEB which is the highest organ of coordination within the UN system. The CEB meets twice a year under the chairmanship of the UN Secretary-General and reports on its activities to the Economic and Social Council (ECOSOC).

[5] Quote from https://www.wto.org/english/thewto_e/coher_e/wto_un_e.htm. On internet pages of the UN, the same aspect is presented somewhat differently (see below Chapter 15).

2 WTO-rules on agricultural subsidies[6]

In accordance with upheld border protection, developed countries for decades designed their agricultural policies based on domestic considerations. The worst articulation of these policies consisted in using the international market as a dumping ground for agricultural surplus production which was often caused by unwarranted domestic support. Prices of agricultural commodities on the world market tended to be formed by excess supply and demand and were correspondingly volatile.[7]

The Uruguay Round leading to the establishment of the World Trade Organization was the first negotiating round to make significant progress in setting out rules governing agricultural trade and establishing a framework for future trade liberalisation in this sector. Indeed, negotiators viewed this agreement as only a start to bringing agriculture under world trade rules. However, after more than a decade of negotiations, the Doha Development Round continues to fall short of delivering the results expected at the time. Still, while remaining subject of review, the provisions on agriculture on which the GATT member states agreed in the Uruguay Round are comprehensive and far reaching. They cover more than just admissible tariffs. They restrict also domestic agricultural policies, and in a significant way.

The Agreement on Agriculture[8] was one of twenty-nine agreements reached in the Uruguay Round. Under this agreement, there are general rules pertaining not only to market access, but also to subsidies (domestic and for exports). As a second pillar, each individual participant also agreed to its own specific policy commitments, mainly in the area of binding tariffs.[9]

Why is the aspect of subsidies in agriculture so important, much more so than in the field of manufactures? The reason are the high values of subsidies when set into relation to the value added of the sector. "Subsidies of all kinds reported to the WTO total more than US-$ 200bio per year, or roughly one-sixth of the US-$ 1.2 trillion total value added in the agricultural sector worldwide. A few countries dominate the total dollar value of subsidies granted. The EU and the US grant about one-third of the world total each – the EU somewhat more than the US because its agricultural sector is slightly larger – and Japan grants almost 12 percent."[10]

The importance of subsidies in shaping the market results is so important that not only subsidies granted to exports of agricultural products were limited.[11] Also subsidies granted to producers fall under disciplines, independent of the fact whether the subsidised products are exported or not, as we will immediately explain.

Domestic subsidies: The Agreement on Agriculture allows countries to use domestic support policies to assist farm and rural incomes and protect the environment. However, it seeks to limit policies that directly impact production and thereby distort international trade and potentially injure other WTO members. Subsidy programs that have a direct impact on production are said to be "coupled" and subsidy programs that are minimally production and trade distorting are defined as "decoupled". To this end, the agreement established various "boxes": the "Amber Box" consists of subsidies that have a direct impact on production, the "Blue Box" pertains to subsidies that impact production but include requirements that agricultural producers limit production, and the "Green Box" consists of subsidy practices considered to be minimally distortive and therefore fully permissible. Additionally, two types of permissible 'de minimis' exemptions were set out.

To reduce Amber Box subsidies that distort production, the WTO agreed to an index – the "Aggregate Measurement of Support (AMS)" – which includes both budgetary outlays and revenue transfers from consumers to producers as a result of policies that distort market prices. Thirty-five WTO members, including the U.S., committed to reductions in the aggregate measurement of the support they give to their producers. The

[6] Most of the text is from Krist, William (2007): Trade Policy and the Farm Bill, Woodrow Wilson Centre.

[7] The latter feature has not fundamentally changed, however. One aspect are underlying features of agricultural markets such as low short term supply and demand elasticities. Another was that the use of agricultural safeguards like export bans could not be disciplined by the Uruguay Round.

[8] The Agreement on Agriculture can be found on the WTO web site at http://www.wto.org/english/docs_e/legal_e/14-ag.pdf.

[9] Each WTO member country has submitted a list of specific commitments, including tariffs, quotas and subsidies to the WTO, which can be found at http://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm

[10] US Congressional Budget Office (2006): "Agricultural Trade Liberalization", Economic and Budget Issue Brief, November 20, 2006, p. 3. The total includes Green Box as well as trade and production distorting subsidies.

[11] In fact, as they usually fall in the "Red Box", they are essentially prohibited and existing such subsidies should have been phased out by 2013.

developed countries committed to a 20 percent reduction in support by 2000, developing countries committed to a 13 percent reduction by 2004, while the least-developed countries committed to no increases in AMS beyond levels applied in 1995 or 1986.

The U.S. committed to maintaining AMS subsidies at a level no higher than US-$ 19.1bio after 2000. The actual level of the U.S. AMS programs generally amounts to around US-$ 13bio. However, in years when commodity prices are low (and consequently loan deficiency payments are high) U.S. AMS payments have reached amounts as high as US-$ 17bio. The EU's annual AMS limit is € 67.2bio, although in the 2003/04 marketing year Amber Box subsidies by the EU amounted to € 30.8bio only. Japan's AMS limit is higher than the one of the U.S., although the notified use is considerably lower than allowed. Japan's AMS ceiling is just under 4 trillion yen, equivalent to roughly € 33bio at the current exchange rate.

Green Box subsidies exempted from WTO commitments include such practices as research, conservation, disaster payments, food stamps, and rural development.[12] Decoupled direct subsidies are also included in the Green Box.[13] Essentially, decoupled direct subsidies should be paid for surfaces that are not left fallow, but the payment should not be linked to the specific production taking place on these surfaces, and the payment should also be assessed on past and not current agricultural areas. Blue Box subsidies, which distort production by being product specific but include limits on production, are also exempted from WTO commitments. Seven countries, including the U.S., have notified practices under this exemption, although the U.S. discontinued its blue box programs with passage of the 1996 farm bill.

Additionally, there are two categories of allowable 'de minimis' subsidies under the Agreement on Agriculture. The first is defined as commodity specific support that is less than five percent of the commodity's value of production for developed countries, or ten percent for developing countries. The second allows exclusion of non-product specific support provided it does not exceed 5 percent of the total value of agricultural production for developed countries and ten percent for developing. It was recognized that 'de minimis' subsidies are trade distortive, but as a negotiating matter in the Uruguay Round it was also recognized that this outlet was the best that could be agreed upon and that this issue would be revisited in the next round.

Export subsidies: Export subsidies distort both production and trade of agricultural products; the WTO divides these subsidies into "direct" and "indirect". Direct subsidies are defined as explicit cash payments per unit of product exported, and include such practices as direct export payments contingent on export performance, sales of government stocks at prices lower than the comparable domestic price, export payments financed through government action such as a levy on producers, subsidies to reduce export marketing costs other than widely available export promotion and advisory services, and subsidies on goods incorporated into export products. At the time, twenty five WTO members agreed to reduce direct export subsidies; the United States and other developed countries agreed to reduce direct export subsidies by 36 percent by value and 21 percent by volume, while developing countries committed to reductions of 24 percent by value and 14 percent by quantity.

"The EU makes the greatest use of such subsidies, providing 85 percent to 90 percent of the export subsidies reported by the 25 countries (that made commitments to reduce export subsidies). The United States has accounted for between 1 percent and 2 percent. The EU's export subsidies have averaged 6.6 percent of the value of its exports; the United States', about 0.05 percent."[14]

Indirect export subsidies include practices such as export credit guarantees, export promotion and information activities, and tax benefits. Additionally, some would include certain types of food aid as indirect export subsidies. Uruguay Round negotiators were not able to reach agreement on how to deal with these practices, except for a restriction on the use of exempted export marketing

[12] While these subsidies are generally considered non-distorting, it should be noted that some countries argue that some practices may in fact be trade distorting, and in the Doha Round they are pressing for caps on the admitted amount of such subsidies, although it is unlikely that this will be agreed to in the Doha Round.

[13] See page 14 in the panel report of the Dispute Settlement Body in the case opposing Brazil and the US, in which the WTO found U.S. direct payment program would not qualify for Green Box because fruits and vegetables were excluded from eligibility. https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(@Symbol=%20wt/ds267/r*%20not%20rw*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#

[14] US Congressional Budget Office (2006): "Agricultural Trade Liberalization", Economic and Budget Issue Brief, November 20, 2006, p. 4.

practices that could circumvent their export subsidy commitments (Art. 10.1 and 10.3). They only agreed to continue work to develop agreed rules to discipline the use of export credit programs.

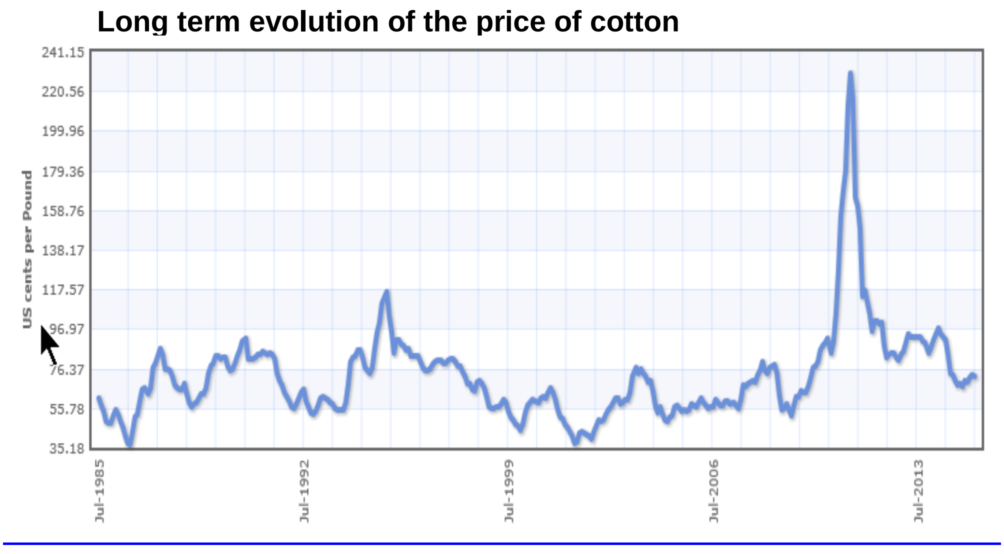
Market Access: Most countries producing agricultural goods have historically maintained tariff and non-tariff barriers to protect their domestic producers and preserve the rural society. Prior to the Uruguay Round, these practices were generally not subject to international discipline. As a first step in the Uruguay Round, non-tariff barriers were converted to tariffs at their equivalent level of protection (a process known as "tariffication") and were bound at their 1 January 1995 levels. A system of safeguards specific to the agricultural sector, which allows additional tariffs to be imposed if imports exceed trigger levels or if import prices fall below trigger levels, was put in place. Additionally, for many agricultural products, tariff rate quotas were conceded by countries in order to satisfy the request for a sufficient market access while shielding local production; tariff rate quotas permit some imports at a low tariff level while imports above this level are charged substantially higher duties.

It was also agreed in the Uruguay Round that all WTO members would bind the maximum tariff rates that could be applied to imports of agricultural products at the 1986-88 levels, which means that they could reduce applied tariffs from these rates but could not exceed them. Developed countries bound their rates at the applied rates, while developing countries could have "ceiling bindings" considerably higher. Developed countries further agreed to reduce these bound rates by 36 percent on average by 2000, and developing countries agreed to a reduction of 24 percent by 2004.

3 Main features of the global trade in cotton[15]

In the rest of this chapter, we will focus on cotton. The reason is that the Brazil-US litigation on US subsidies for growing and exporting cotton suits best to illustrate how enforcement within the WTO works in reality. Before, major features of trade in cotton are presented in this section.

In 2014/15, the USA remained with 30% the main exporter of cotton in the world. India with 13%, Brazil with 11%, CFA-Africa with 11%, Australia with 8% and Uzbekistan with also 8% followed. While in CFA-Africa (i.e. the countries using the CFA franc) 77% of production was exported, this share was 66% in the USA, 65% in Uzbekistan, 54% in Brazil, while only 15% in India.[16]



Cotlook 'A Index', Middling 1-3/32 inch staple, CFR Far Eastern ports, US cents per Pound[17]

Overall, more than 30% of production is traded. China dominates as importer, but China's imports shrank from an excessive 5mio t in 2011/12 to a more normal 2mio t in 2014/15. These figures

[15] Pandolph, Rebecca (2015): Contribution to the 3rd dedicated discussion of the trade-related developments on cotton at the WTO, 9th July 2015. The author is with the International Cotton Advisory Committee. See link at the bottom of https://www.wto.org/english/news_e/news15_e/cdac_09jul15_e.htm

[16] Australia exported 124%, reflecting either re-exports or a depletion of stocks or both.

[17] http://www.indexmundi.com/commodities/?commodity=cotton&months=360

have to be confronted with a production of some 8mio t per year on average. China's demand spike in 2011/12 is the major explanation for the price hike in the graph above. China in fact constituted huge stocks in 2011/12. For 2014/15, China's imports amounted to some 23% of the world total, followed by Bangladesh (13%), Vietnam (12%), Turkey (10%) and Indonesia (10%), the rest of the world absorbing one third of the total traded. Looking at the processing of cotton, 32% of the world total occurs in China, 22% in India, 10% in Pakistan, 6% in Turkey, 4% in Bangladesh and 3% in Brazil, USA and Vietnam, respectively. 17% is processed in the rest of the world.

International cotton prices have been historically high up until 2014 and the trade distorting effects of government policy, such as the one by the US, had not been as important as in the past. However, if prices were to fall again, income guarantees as foreseen in the Farm Bill 2014 could support US production and hurt some of the poorest farmers in the world, as this had been the case with support granted by the 2002-2006 farm bill (see below). Assistance to the cotton sector increased somewhat from below US-$ 4bio a year around the turn of the century to somewhat more than US-$ 4bio recently, with a peak of close to US-$ 12bio in 2010/11 ! The International Cotton Advisory Committee mentions the following measures:

- China: Direct subsidy to cotton producers based on the difference between the target price and the average market price
- India: Minimum Support Price with purchases by the Cotton Corporation of Indian and Maharashtra Federation in 2014/15
- United States: Crop insurance and STAX-premium subsidies for "shallow" revenue loss (10-30% below expected income)
- Brazil: Minimum Support Price (PEPRO) where government guarantees price without acquiring cotton
- Turkey: Premium paid for using certified seeds
- European Union: Continuation of the support scheme under the new Common Agricultural Policy.

On average over the last years, half of world production was eligible for assistance. A detailed description of the national measures can be found in a background paper prepared by the Secretariat for the WTO Committee on Agriculture.[18]

It is worth mentioning that the last fifteen years have shown that cotton acreage in the U.S. is responsive to market forces.[19] High soybean and corn prices reduced cotton acreage and production only recovered in response to higher world cotton prices. In fact, much has changed in cotton production since the burdensome supply years of 1999-2002. For those years, the U.S. harvested an average of 13.2mio acres of cotton per year, 16.6 percent of world harvested acres, produced 17.9mio bales of cotton, 19.5% of the world total, exported 9.1mio bales, 32.3% of the world total, and had annual domestic utilization of 8.5mio bales, 9.0% of world use. For the 2011, 2012 and 2013 crops, U.S. cotton harvested acreage averaged 8.8mio acres (down 4.4mio acres), 11.6% of the world total (compared to 19.5% in 1999-2002), and U.S. production averaged 15.3 million bales, 14.3% of the world total (down from 32.2%).

4 The impact of US subsidies for cotton on producers in the C4-countries

As said, to show what the commitments under the agreement of agriculture referring to subsidies signify in practice, we will concentrate in what follows on the domestic (and export) subsidies granted to cotton producers in the U.S., the choice of this crop being motivated by the fact that Brazil challenged U.S. cotton subsidies by using the dispute settlement mechanisms formally established in the WTO provisions. This leading case brought also some insight on how the articles in the Agricultural Agreement should be read, as a lot of generous interpretations of these articles have been made (that is to say that in the transposition of WTO obligations into national policies a lot of chiselling has occurred).

The first U.S. farm bill had been passed by Congress in 1933 during the Great Depression to give financial assistance to farmers who were struggling due to an excess crop supply creating low prices. Beginning in 1973, farm bills included 'titles' (i.e. chapters) on commodity programs, trade, rural development, farm credit, conservation, agricultural research, food and nutrition programs, marketing, etc. The 2002 Farm Bill (The Farm Security and Rural Investment Act), which expired in September 2007, was setting out the basic U.S. farm policies when the U.S.-Brazil litigation started. According to the view held in the report prepared by the Woodrow Wilson Centre

[18] WTO Committee on Agriculture Special Session of the Sub-Committee on Cotton, 14 November 2014, TN/AR/SCC/GEN 13 Rev.1

[19] de Gorter, Harry (2012): The 2012 US Farm Bill and Cotton Subsidies - An assessment of the Stacked Income Protection Plan, International Centre for Trade and Sustainable Development (ICTSD), Issues Paper 46, Dec.2012

on which we build in this section,[20] Title I of this legislation, which establishes income support programs for wheat, feed grains, upland cotton, rice and oilseeds, has the greatest implications for trade policy, both with regard to the Doha Trade Round and potential dispute settlement cases. Title III pertaining to programs to expand commercial sales and international food assistance has some relevance to the Doha Round, and Title IX regarding biofuels could be subject to future trade disputes if U.S. programs are not drafted with WTO rules in mind. The other programs established by this legislation were generally considered non-trade distorting and have not been stumbling blocks in the trade negotiations or targets of trade disputes.

In authorizing U.S. farm programs, the 2002 Bill uses different terminology for funding various programs than does the World Trade Organization. Title I on commodity programs provides for income support for wheat, feed grains, upland cotton, rice, oilseeds and peanuts through loan deficiency payments, counter-cyclical payments (CCP) and direct payments, as well as special programs for sugar and dairy. We quickly present the three main instruments:

Loan deficiency payments are paid when farm prices fall below levels specified in the legislation, so they increase in relation to falling prices. The payment rates are based on local prices for wheat, feed grains and oilseeds, or the world price for rice and upland cotton. Loan deficiency payments are based on current production, and are considered to be trade distorting. Since 1996, the largest recipients of loan deficiency payments have been corn (US-$ 13.5bio), soybeans (US-$ 8.7bio), cotton (US-$ 3.6bio), wheat (US-$ 2.4bio), and rice (US-$ 1.8bio). Sorghum, barley, oats, sunflowers, and canola have all received between US-$ 100mio and US-$ 1bio. Minor amounts (less than US-$ 50mio) have been received by honey, triticale, peanuts, wool, mohair, chickpeas, lentils, sunflowers, flaxseed, and some oilseeds.

Counter-cyclical payments rise in relation to falling prices, and are paid when prices fall below levels specified in the legislation. Counter-cyclical payments are not directly linked to current production because they are made on a historical base acrage for a given crop. Accordingly they are considered less trade distorting than loan deficiency payments, but more so than direct payments. To be eligible for counter-cyclical payments, participants must maintain their land for agricultural use, which includes letting it lie fallow or for pasture. Additionally, they can plant their acreage to any crop, except fruits and vegetables which are specifically excluded. Cotton is the largest recipient of countercyclical payments followed closely by corn. Peanuts and rice receive far less, and small amounts are received by sorghum, barley, wheat, and soybeans.

Direct payments: Rates are set out in the legislation for eligible commodities. A producer must enter into an annual agreement with the Department of Agriculture to receive payments, which are based on historical acreage and yields of eligible commodities. To be eligible, participants must maintain their land for agricultural use, which includes letting it lie fallow or for pasture. Additionally, they can plant their acreage to any crop, except fruits and vegetables which are specifically excluded. The amount of payments does not vary based on the price of the commodity or level of production, and accordingly these payments are considered to distort trade less than either loan deficiency payments or counter-cyclical payments. Major recipients of direct payments are corn, wheat, cotton, soybeans, and rice. Minor recipients are sorghum, barley, peanuts, canola, crambe, flaxseed, mustard seeds, oats, rapeseed, safflower seed, sesame seed, and sunflowers.

As can be seen in the table on the next page, corn has been the largest recipient of U.S. subsidies, followed by cotton. Wheat, rice, soybeans and peanuts have been other significant recipients. But why can these amounts be relevant for producers in other countries, and in particular in Least Developed Countries such as those in Western Africa? Julian M. Alston, Daniel A. Sumner, and Henrich Brunke from the University of California[21] have estimated the impact reductions in US Cotton Subsidies can have on West African Cotton Producers (more specifically the C-4, namely Benin, Burkina Faso, Mali and Chad). They did this on behalf of 'oxfam', an international relief and development organization promoting lasting solutions to poverty, hunger, and injustice, but their analysis is transparent and might be reproduced with other sets of assumptions.

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[20] Krist, William (2007): Trade Policy and the Farm Bill, Woodrow Wilson Centre

[21] Alston, Julian M. and Daniel A. Sumner, and Henrich Brunke (2007): Impacts of Reductions in US Cotton Subsidies on West African Cotton Producers, Oxfam America

U.S. Subsidy Programs[22] (in billions of dollars) FY 2002-2006:

	Loan Deficiency Payments	Countercyclical Payments	Direct Payments	Total Payments
Rice	0.7	0.5	1.3	2.5
Cotton	0.9	4.3	1.8	7.0
Wheat	0.2	negl.	3.4	3.6
Corn	7.0	3.8	6.2	17.0
Soybeans	0.3	negl.	1.8	2.1
Peanuts	negl.	0.7	0.2	0.9

A first step in their analysis is to assess for each program the rate at which a pure subsidy would have to be disbursed to create the same incentive effects. In terms of production incentives, marketing loan revenue was considered as equivalent to market revenue. The incentive effects on farmers out of revenues from direct payments and counter-cyclical payments were considered to be less than one, but still positive. The relevant argument with respect to direct payments is that they are linked to restrictions in planting of fruit and vegetables and that direct payments as well as insurance schemes are based on the area where cotton was planted in prior years, so that these restrictions will keep some cotton-base land in cotton production.

Expressed in terms of a direct producer subsidy, the outlays of the U.S. cotton programmes of 2004/2005 were then integrated in a simulation model where the driving parameters are market shares as well as supply and demand elasticities combined with price transmission elasticities for the three regions distinguished in their model, namely the US, the C-4 and the rest of the world. The estimated impacts of US subsidies on C-4 countries range from US-$ 43mio per year to US-$126mio per year, with more likely parameter values implying effects in the range of US-$ 80mio per year. These amounts show that the world price would rise and how much the C-4 African countries would gain if US cotton subsidies were cut. The amounts indicated can be assimilated to a tax or a negative producer subsidy falling on C-4 producers.

When compared to the annual producer subsidies granted by Switzerland to its farmers of more than US-$ 5.5bio,[23] the harm done by the U.S. cotton programs amounting for C-4 producers of US-$ 80mio appears as negligible. But the C-4 countries rank at the very end of the worldwide income per capita scale, so that this amount has to be set into relation to a GNP of the C-4 countries of some US-$ 45bio and total exports of some US-$ 10bio (as of 2012 approx.). As they represent a drop of close to 1% in export earnings and 0.2% in GDP, the US-$ 80mio are a relevant amount.

The authors therefore go on and translate these US-$ 80mio into revenue improvements at the farm level in the C-4-countries. To this end, they use two alternative price transmission hypotheses – 80 percent and 50 percent transmission of per unit changes in export prices to per unit changes in farm prices for cotton fiber. For the 50 percent price transmission, the percentage change in the farm price is smaller than the percentage change in the export price, for the 80 percent it would be larger.[24] Following these assumptions, for farm price increases in the range of 5 to 20 percent, farm revenue from cotton

[22] US Department of Agriculture (2006): Fiscal Year 2006 Budget Summary and Annual Performance ... www.**usda**.gov/documents/FY06budsum.pdf

[23] The CHF 5.5bio represent the Producer Subsidy Estimate calculated for Switzerland by the OECD for 2011. In the same vein as Alston, Sumner, Brunke proceed for U.S. cotton subsidies, the OECD adds when calculating this measure to direct support granted to farmers the extra income they derive from tariff protection at the border and similar supportive measures. For this reason, the US-$ 5.5bio are on a similar scale as the US-$ 80mio calculated for the C-4. We leave it to the reader to imagine what US-$ 5.5bio disbursed on C-4 producers would allow to achieve.

[24] 80 percent of the margin between the price at the farm and the export price is made up of fixed costs which do not change with the price of cotton. If intermediaries cannot increase their margin under the pressure of competition, an 80% pass-through results. 50% pass-through refers to a case where they take out part of the final good's price increase.

would increase by at least 10 percent, and possibly by as much as 40 percent. With a smaller supply elasticity of 0.4, farm revenue from cotton would increase by at least 7 percent, and possibly by as much as 27 percent. Allowing for a range of supply responses in the United States and in Africa to world price changes, elimination of US subsidies would result in an increase in the world price for cotton of between 6 and 14 percent, in round figures, a change in farm prices of cotton in the range of 9 to 35 CFA per kg. Using 2.6 tons of seed cotton per farm, price changes in this range would provide increases in gross and net income from cotton production of between 23'400 and 88'400 CFA per farm per year (about 40 percent of total cotton revenue on cotton farms is spent on inputs purchased off the farm). This is a significant amount when compared with net returns from cotton of 290'000 CFA per farm per year. Using the average expenditure per household (with about 10 members) of about 1mio CFA, the additional income from removing US cotton subsidies would add between 2.3 percent and 8.8 percent to the average expenditures of cotton producing households. This would be sufficient to support food expenditure for an additional 0.4 to 1.6 persons per household. Of course, the extra income could also serve other purposes, e.g. an improvement of the very poor equipment at the farm level. Such investment would then have longer lasting beneficial effects for a very poor population.

5 Trade remedies: The Brazil-US cotton dispute[25]

The US had been a major driver of the Agreement on Agriculture, and viewed the agreement as key to making WTO member country policies more market-oriented, and improving predictability and access for U.S. exported products. As the lead U.S. agriculture negotiator in the Uruguay Round Joe O'Mara said: "The United States was the primary driver, and we were the ones who advanced the rules for domestic support and export subsidies." [26] In the Brazil-US litigation on cotton subsidies, the U.S. made the experience that the agreed disciplines fell also on the authors.

The dispute settlement mechanism of the World Trade Organization represents a major advance of the WTO over the previous General Agreement on Tariffs and Trade (GATT), its predecessor 'organization' from the end of WWII to 1995. Under GATT, nations relied largely on the integrity of their trade partners to adhere to the trade rules, as the dispute settlement process lacked real sanctions. However, under the WTO dispute settlement process, real timelines are in place for resolving disputes, and an appeals mechanism was established. Under these provisions, the losing party must either bring its policies into conformance with panel rulings, or provide compensation satisfactory to its WTO trading partners. If this is not accomplished, then retaliation is authorized, which may adversely affect other products.

This new dispute settlement mechanism went into effect in 1995 when the WTO came into being. However, for agriculture, WTO members agreed to exercise "due restraint" in bringing dispute settlement cases against other WTO members - the so-called "Peace Clause" - until the end of 2003, when it was hoped a new, further reaching agreement on agriculture could have been achieved. With the expiration of that commitment and the failure of WTO members to agree to new commitments on agriculture, a number of dispute settlement cases had been brought to the WTO. The U.S. e.g. successfully brought dispute settlement cases against Japanese rules on apples, an EU moratorium on bio-tech products or EU restrictions on beef hormones. In the latter case, the EU maintained its restrictions and the U.S. retaliated with tariffs of 100% on other products the EU exported to the U.S. such as hams.

In order to bring a successful WTO case regarding agricultural subsidies, the complainant has to prove that the magnitude of the subsidies is excessive, that the commodity is relevant to world markets, and that there is a causal relationship between the subsidy and injury. Given the difficulty of winning a dispute, some argue that there are several reasons why additional dispute settlement cases might not actually be brought. First, bringing a successful dispute settlement case in the WTO requires a large investment in both finances and human capital, and many developing countries would not have the resources to undertake such an effort. Additionally, a potential complainant might have geopolitical concerns that would discourage it from bringing a confrontational WTO dispute settlement case.

Such was not the case in September 2002, when Brazil challenged U.S. subsidies to cotton under the WTO dispute settlement procedures, arguing that the 2002 Farm Bill violated the WTO Agreements. Brazil specifically criticized domestic support measures, export credit guarantees and other measures that it alleged were export and

[25] WTO Dispute Settlement Body (2014): Dispute DS267: United States — Subsidies on Upland Cotton https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds267_e.htm

[26] Quote found in Krist, William (2007): Trade Policy and the Farm Bill, Woodrow Wilson Centre, p.6, on which also a large part of the rest of the text in this section is based.

domestic content subsidies. It claimed that these subsidies caused the U.S. to produce excess supplies of upland cotton, thereby depressing world prices.

In September 2004, the WTO panel circulated its report. It found that Step 2 subsidies, loan deficiency payments and countercyclical payments together resulted in serious prejudice and thus violate U.S. WTO commitments. Additionally, the export credit guarantee program under Title III of the 2002 Farm Bill was also judged to be WTO inconsistent.

The U.S. appealed the panel ruling in October 2004, and the Appellate Body report was released on March 5, 2005. Overall, the Appellate Body upheld the panel findings. Some of its rulings read as follows:

- Step 2 payments to exporters of U.S. upland cotton constituted subsidies contingent upon export performance and were prohibited export subsidies, not least so because the subsidies were contingent on the use of domestic over imported goods. Step 2 subsidies were initially put in place to help the textile industry and generally amounted to around US-$ 300mio to 400mio annually. In fact, under this program, when the U.S. price was higher than the world price, the government gave the industry payments for exporting.

- The (domestic) subsidy programs at issue – i.e. marketing loan program payments, market loss assistance payments, and counter-cyclical payments – caused significant price suppression and serious prejudice to Brazil's interests. However, it ruled that other US domestic support programs (e.g., direct payments[27] and crop insurance payments) did not cause serious prejudice to Brazil's interests because Brazil failed to prove a necessary causal link between these programs and significant price suppression.

- U.S. export credit guarantee programs at issue were export subsidies and thus, circumvented the U.S. export subsidy commitments. The Appellate Body, in a majority opinion, also upheld the Panel's finding that the Agricultural Agreement Article 10.2 does not exempt export credit guarantees from the export subsidy disciplines in Article 10.1 of that agreement.

When the United States failed to meet deadlines for compliance, Brazil claimed the right to retaliate against US-$ 3bio in U.S. exports to Brazil based on the prohibited subsidies, and proposed US-$ 1bio in retaliation based on the actionable subsidies. The United States objected to these retaliation amounts and requested WTO arbitration on the matter. In mid-2005 the United States and Brazil reached a procedural agreement to temporarily suspend retaliation proceedings.

In February 2006, Congress approved a bill that repealed the Step 2 subsidy program for upland cotton, which took effect in August 2006. Additionally, the Administration proposed to change the export credit guarantee program in the 2007 Farm Bill.

However, Brazil did not believe these measures adequate and in August 2006 requested the establishment of a WTO compliance panel to review whether the United States has fully complied with panel and Appellate Body rulings. The panel issued its report July 27, 2007, and found the U.S. response inadequate.

Before Brazil's implementation of countermeasures, the United States and Brazil managed to reach a temporary agreement,[28] by which the United States agreed on a temporary monetary compensation to Brazil and committed to certain interim adjustments to the GSM-10.2 program, until a definitive solution could be achieved in the next Farm Bill. Indeed, Brazil (and the C-4) had an interest to be compensated since the default remedy of import tariff retaliation on U.S. goods would not have helped Brazilian cotton growers or agricultural exporters and would have added to the cost of critical imports from the U.S. As part of the agreement, the U.S. was paying US-$ 147.3mio per year to the Brazilian Cotton Institute for cotton research and development. The U.S. government quit making those payments in the Fall of 2013, however, saying they no longer had the authority to do so.

One advantage for Brazil to accept an agreement with the United States on cotton is seen in the consideration that it provides a commitment mechanism whereby Congress will be restrained from legislating additional interventions should a downturn in prices occur in the future.

[27] Direct payments were criticised for excluding eligibility when specified cultures were planted on them.

[28] The Memorandum of Understanding between Brazil and the United States regarding a Cotton Fund, signed in April 20, 2010, and the Framework for a Mutually Agreed Solution regarding the Cotton dispute, signed in June 25, 2010.

6 The U.S. Agricultural Act of 2014

A new five-year Farm Bill, initially attended for 2012, was finally signed by the U.S. President in February 2014 after long and controversial discussions in and between the two chambers of the U.S. Parliament. Reaffirming the government's support to farmers, the Agricultural Act 2014[29] ends fixed payments while reinforcing a decade-long shift to subsidized crop insurance.

Essentially, the new law eliminates about US-$ 4.5bio annually in fixed direct payments to farmers, such payments having been made since 1996. In place of these payments, greater protection against low prices will be offered. The spending in the bill (FY 2014-2023) breaks down in the following manner: Food stamps and nutrition US-$ 756bio, crop insurance US-$ 89.8bio, conservation US-$ 56bio, commodity programs US-$ 44.4bio, everything else US-$ 8.2bio.[30] However, financially, anything can happen given the large share of insurance programs within the bill - from substantially lower spending to much higher support costs, depending on how market prices and farm revenue turn out.

With regard to insurance in general, farm operators will need to decide which programs to opt for, crop by crop. According to the Price Loss Coverage program, for example, the corn target price is increased from US-$ 2.63 to US-$ 3.70 per bushel. If market prices fall below this target, farmers receive a payment of the difference on a "base" quantity of their output. The base acreage for specific crops and base yields per acre can be increased according to production in the past five years. The alternative is the Agricultural Risk Coverage (ARC) program. Under this option, there is a cushioning guarantee against declining revenue, not a fixed target price guarantee. For example, for corn, ARC payments would be triggered (assuming yields at typical levels) by prices below US-$ 4.55 per bushel. The ARC guarantee adjusts according to a rolling average of revenue over five previous years. The new Farm Bill also reinforces recent years' increased support through subsidized within-year yield and revenue crop insurance programs. The Supplemental Coverage Option e.g. allows farmers to purchase subsidized insurance for yield or revenue losses greater than 14 percent up to the level of losses met by their other insurance coverage. Farmers choosing the ARC are ineligible because its revenue guarantee covers similar downside risk.

In the case of cotton, the shift to insurance, a change supported by producers quite early on in the farm bill debate, is intended to circumvent the WTO dispute settlement ruling against previous cotton support programs and bring the U.S. into compliance with WTO requirements under that case. The special scheme set up for this crop is called STAX, "Stacked Income Protection Plan". STAX provides coverage for county-wide revenue losses. If the producer purchases additionally an individual insurance policy, STAX would sit on top and cover losses ranging between 10% and 30% of expected county revenue, so 70–90% coverage is available with STAX. STAX is subsidized by the federal government at 80%, so the producer portion of the premium will be 20%. This scheme is to be seen as a compensation for the elimination of the direct and countercyclical payments (DP and CCP), in particular the latter having been deemed trade distorting in the WTO ruling in the US-Brazil Upland Cotton dispute. The marketing loan program will be maintained, except that the loan rate for cotton has been singled out to decline if market prices fall below it.[31]

How does the new insurance scheme compare with the abolished measures? Cotton producers received a countercyclical payment CCP every year as cotton prices were – allegedly, see graph above – "depressed", i.e. up until the 2010/11 crop year, while wheat and soybean producers have never received a CCP payment. Coble, Barnett, and Miller (2012) used a simulation model to conclude that the average STAX payment was about US-$ 26/acre. Karov, Wailes, and Watkins (2012) indicated that none of the representative farms for Arkansas would benefit from STAX as compared with the direct payments under the 2008 Farm Bill. Average payments ranged from US-$ 1 to US-$ 46 per acre for the 70–95% coverage levels. Westhoff and Gerlt (2012) estimated an annual STAX payment of approximately US-$ 40/acre. Orden, who resumes these studies, estimates himself that for many of the counties, a DCP payment (or STAX with reference price) would have been made in 'only' 5 or 6 of the 10 years. Overall, producers would have received more payments under the direct payments program than they may expect under the

[29] Based on Orden, David (2014): The US Agricultural Act of 2014: Overview and analysis, Discussion Paper released by the International Food Policy Research Institute (IFPRI) (co-author Carl Zulauf)

[30] According to Plumer, Brad (2014): The $956 billion farm bill, in one graph, The Washington Post, 1-14-14 http://www.washingtonpost.com/news/wonkblog/wp/2014/01/28/the-950-billion-farm-bill-in-one-chart/

[31] http://www.fsa.usda.gov/FSA/newsReleases?area=newsroom&subject=landing&topic=pfs&newstype=prfactsheet&type=detail&item=pf_20140311_insup_en_fbil.html for more information.

STAX program, which may be expected since direct payments are fixed payments.

Finally, the export credit program, known as the GSM-10.2 program, has also become more market driven. The new farm bill further reduced the loan length from 36 months to 24 months and gave the US Department of Agriculture (USDA) more flexibility to increase fees to cover costs to make the program more market-oriented. USDA has also the authority to make changes that Brazil agrees to that do not go beyond any applicable international rules on export credits to which the U.S. is a party. The loan length of 24 months is still longer than the six month limit discussed in recent years at the WTO and the 16 months suggested by Brazil.

7 Achievements of the Brazil-US-cotton dispute

Can the complaint by Brazil against U.S. cotton policies be considered a success? To a considerable extent, yes. Two of the three contested support schemes fell already by 2008 or were modified in a way to conform WTO provisions. This holds true for Step 2 payments to U.S. textile manufacturers and for the U.S. export credit guarantee programs, where – as stated above – to come to a deal with Brazil is a clear objective. It proved more difficult to revise the domestic support schemes directly favouring U.S. farmers.

A number of authors claim that the abolishment of direct payments was a move in the direction of higher WTO conformity of U.S. agricultural policies.[32] This is only true up to a very limited point. The study by the University of California sees direct payments as the least distorting of the three schemes examined,[33] and the straightforward modification with this scheme would have been to drop the requirement that land qualifying for direct payments shall not be used to cultivate fruit and vegetables.

The salient point with regard to trade distortion are the incentive affects relevant for particular crops, and the relevance of insurance schemes in this regard is not easy to assess. If prices or revenue fall short of expectations, this can signal not only an exceptional year due to weather conditions a.s.o., the results can also express a lasting, underlying structural change in the market.

Crop Insurance assessed against WTO rules

As Keith Collins[34] *observes in an analytical paper dealing among other aspects with the WTO conformity of U.S. crop insurance schemes, crop insurance programs may be green box if several criteria are met: (1) Eligibility for payments must be determined by an income loss which exceeds 30 percent of average gross income or the equivalent in net income terms (excluding any payments from insurance or similar programs) in the preceding 3-year period or a 3-year average based on the preceding 5-year period, excluding the highest and the lowest years. (2) Payments must compensate for less than 70 per cent of the producer's income loss in the year the producer becomes eligible to receive this assistance. (3) Payments must relate solely to income, not to the type or volume of production undertaken by the producer, or to domestic or international prices applying to such production, or to the factors of production employed. He then continues: Because U.S. crop insurance provides support in excess of 70 percent of a producer's income loss and losses are measured from a base of 4- to 10-year average yields (not 3-year averages), the U.S. program is not green box (nor blue box).*[35] *Crop insurance for specific products has to be reported as product specific amber box support and would be counted as part of the AMS, the overall limit on amber*

[32] Harry de Gorter from Cornell University surprisingly estimates: Elimination of direct and countercyclical payments can have very significant reductions in trade distortions – the trade distorting effects of these programs have been significant in the past. In: de Gorter, Harry (2012): The 2012 US Farm Bill and Cotton Subsidies - An assessment of the Stacked Income Protection Plan, ICTSD Issues Paper 46, Dec.

[33] The more-detailed results from an analysis of the implications of a removal of particular forms of subsidy indicated that the marketing loan program would be the most important program to cut and that the counter-cyclical payments are also significant.

[34] Keith Collins (2009): Future of Crop Insurance in Volatile Markets. The author is consultant at the National Crop Insurance Services, Overland Park, Kansas, USA. The text is retrieved from a Russian website on agro-insurance (HTTP://WWW.AGRO-INSURANCE.COM/EN/ANALYTICS/?PID=10872)

[35] In 2008, 72 percent of premium was on polices with coverage levels of 70 percent or more (i.e., 30-percent deductible), compared with only 15 percent in 1998. The higher coverage levels are in response to increased subsidies and required coverage for government supplemental disaster payments. The record-high crop prices in 2008 led to a surge in liability for revenue policies, which pushed total insured liability to a record-high of almost $90

box support called the total Aggregate Measurement of Support (AMS). Collins then argues that U.S. crop insurance is not product specific and would benefit from the fact that some Amber box supports are subject to de minimis limits, which means that minimal supports are not counted in the AMS. For developed countries, the de minimis is 5 percent of the value of agricultural production. Net indemnities are considered non-product-specific because the U.S. premium subsidies are the same percentage of premium regardless of the commodity. The current Doha draft modalities in the ongoing WTO negotiations state that the de minimis level be reduced by at least 50 percent. If that proposal had been in effect for 2008/09, the de minimis limit would have been a little under US-$ 8bio, and the U.S. non-product-specific amber box total would have continued to be under the limit and would not have counted as part of the AMS. Collin concludes: However, current and Doha-proposed rules remain ambiguous, signalling that his argument may be a bit too much 'pro domo'.

Where one can hardly agree with Collins is when he argues: While studies have concluded that crop insurance leads to higher production, the estimated effects are generally small. The following advantages of crop insurance he mentions in his text are indeed likely to expand production significantly: Crop insurance ensures business cash flow by protecting against both yield and price declines, provides a mechanism to manage overall farm risks, meets the requirements of landlords for protection of their interests, meets the requirements of bankers to help ensure performance of farm production loans, and enables producers to forward market a higher percentage of their production with less risk.

If a downturn happens on a global scale, the producers in those countries that are best protected by crop insurance will be the last in the row who will be financially constrained to give up such productions.

In a letter to Congress dated January 2012,[36] Brazil's then Ambassador to the WTO, Roberto Azevêdo,[37] made his country's displeasure with STAX and insurance programmes that guard against "shallow losses" clear. He argued that programmes insulating farmers from market forces could not be compliant with WTO rules.[38] David Owen IPRI also concludes: "From an international perspective, while the case can be argued that the cotton program would not have been changed so sharply without the WTO dispute ruling, there is little else to point to in the new law that moves in the policy direction implied by the idea of WTO disciplines on trade or production distorting support. Indeed, the structure of the new support programs regresses sharply toward those distortions." But he also observes: "With the loose disciplines still existing under the U.S. $19.1bio cap on certain distorting support, it is unlikely that its international commitment will be violated." Indeed, the U.S. are protected against such critique by the fact that a certain amount of amber box measures continues to be allowed, the U.S. not being the country to rely most on amber box measures on a per capita basis. Furthermore, the WTO has detailed provisions regarding insurance schemes. These may even fall in the Green Box. This was shown in the box above which provides an impression on how detailed WTO provisions in some fields are.

billion. In 2009, with lower crop prices, total liability could decline 7 to 9 percent. FCIC sets rates to achieve an expected loss ratio of 0.88, which provides an expected reserve of 0.12. On top of losses come the administrative and operating (A&O) expenses and the underwriting gains of the private companies that administer the scheme in a public-private partnership. The FCIC subsidized nearly 60 percent of the total premium, or $5.7 billion for the 2008/09 crop year.

[36] To be retrieved under http://www.google.ch/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CBwQFjAA&url=http%3A%2F%2Fwww.brazilcouncil.org%2Fsites%2Fdefault%2Ffiles%2FLetterfromARAtoRep.PetersonJanuary2012.pdf&ei=W3PfU57kAYaf0QXf5IH4BQ&usg=AFQjCNFh098JcK5Q9bMRl7zXguM1C8ugLA&sig2=7-qdB6nMa78e_Up8658QMQ

[37] Roberto Carvalho de Azevêdo (born 3 October 1957) was elected to succeed Pascal Lamy as Director-General of the World Trade Organization in May 2013. He assumed office on 1 September 2013.

[38] "We consider that the various proposals presently under discussion would result in subsidy programs that are more trade-distortive than the programs currently in place. The main reason is that nearly all proposals involve: (i) reducing relatively less trade- distorting and largely "untied" direct payments to farmers, as well as historical acreage-

8 The way ahead in WTO agricultural negotiations

WTO rules are cutting.[39] With the entry of the Marrakesh Agreement, some aberrant national policies had to be given up[40] and others could be avoided. To use the world market as a dumping site for excess domestic production has since become more difficult. However, in the two decades since the Marrakesh Agreement, the expectation laid down at the time, namely that there will be a second step of pro-market reforms in the agricultural sector, did not materialise. In the Hong Kong Ministerial Conference of 2008, countries were close to a break-through, but the worldwide economic and financial crisis which spread from 2008 on was not conducive to deepening economic integration. In preparation of the Ministerial Conference of December 2015 in Nairobi, very much the same documents were circulated that had already been on the negotiating table seven years before. Neither in the negotiating group on non-agricultural market access, nor in the one on rules (i.e. on anti-dumping measures, subsidies and countervailing measures and WTO-provisions applying to regional trade agreements), substantive proposals were ready for adoption. Rather, the negotiators were waiting to see how ambitious the result in the negotiations on agriculture would be.

The small package adopted in Bali towards the end of 2013 was neither exciting nor ambitious. With the exception of the Trade Facilitation Agreement which was broadly welcomed and also considered a very relevant agreement for the LDCs, a major achievement appears to be that the signing of an agreement after almost a decade of setbacks made it possible for negotiations to continue.[41] The Trade Facilitation Agreement (TFA) is a new kind of agreement since LDCs have to (i) commit themselves to the same standards as the rest of the world but (ii) will get special measures and assistance to be able to implement these commitments. Therefore, the TFA embodies a shift from an exemption approach towards an ensured integration into the world economy and the global value chains.

The adoption of the TFA was seriously at risk in summer 2014 when India temporarily linked its readiness to formally sign the agreement reached in Bali to the adoption of a permanent solution with regard to national policies aiming at constituting food stocks for food security reasons by paying domestic peasants above world market prices. In Bali, Ministers only agreed on a standstill, i.e. they committed not to bring such cases would they appear and infringe admissible support within the amber box to the Dispute Settlement Body. The new Indian government did not insist on this linkage so that the heads of the permanent delegations to the WTO meeting as General Council could adopt the agreement in November 2014. As part of the agricultural negotiations, the admissible food safety provisions remained in discussion, however.

In July 2015, before the summer break, negotiating groups held their meetings in view of what might be decided in the Nairobi Ministerial Conference in December. Key were, as said, the negotiations on agriculture where the outlook remained depressed regarding a substantive result. This was made clear by the statement of the outgoing president of the negotiating group on agriculture, Ambassador John Adank, reproduced on the WTO internet site.[42] A few excerpts of his statements exhibit major issues discussed and show how limited the chances to come to a substantive agreement were.

In agricultural negotiations, a key issue remains *Overall Trade Distorting Support* (OTDS): Here exemptions provided for some Members in the draft modalities (i.e. the somewhat modified proposal for an agreement discussed in Hong Kong 2008) had been put into question by some other Members, who argue in favour of comparable disciplines for all large subsidizers. This, in turn, made it challenging to get some members to engage on other elements (such as the calculation of the agricultural market support in general, product specific reductions and reductions in the

based counter-cyclical payments, while replacing them, at least in part, by much more trade-distortive programs that provide revenue protection at significantly increased levels and that are tied to current production and prices, and to specific crops; (ii) maintaining, with relatively little change, the program considered to be the most trade-distorting domestic program in the WTO dispute (i.e. the Marketing Loan Program)."

[39] Farmers in Switzerland started to fear a "GAT-Tastrophe".

[40] The Swiss "Cheese Union" which dumped excessive Swiss production mainly of Emmental-Cheese on world markets and provided a cheap and welcome justification for US diary support, had to be dismantled, e.g..

[41] The last two sentences are a quote from: "The way forward after Bali: challenges and opportunities for LDCs – a report of IDEAS Centre's session at the Bali Trade & Development Symposium, Written by IDEAS Centre on 10 January 2014. 'Were negotiators securing their employment?' a cynical observer is tempted to ask.

[42] See https://www.wto.org/english/news_e/news15_e/agng_22jul15_e.htm

de minimis provisions). In *Market Access*, Adank observed that while positions had not substantially evolved, Members demonstrated a willingness to explore alternative tariff reduction approaches on a without-prejudice basis. *Export competition* remained for him essential as part of a wider package. According to Adank, this pillar could be considered to be more mature than the two others. However, in the course of preparations for the Nairobi Conference, issues were raised particularly in respect of the areas of export credits while in the field of international food aid, the question of in-kind food aid monetization remained contested. Finally, not considered within this 3-pillar architecture, some Members renewed their call to strengthen disciplines in the area of agricultural *export prohibitions and restrictions.*

Adank therefore considered that progress could eventually be achieved in the four topics singled out in Bali for a next step forward, after Trade Facilitation. Beyond export competition, these topics are **a**n understanding on tariff rate quota administration provisions for agricultural products,[43] a consensus on general services to the sector which are not considered to constitute subsidies and a permanent solution for public stockholding for food security purposes. Furthermore, it appeared to him as generally accepted that an agreement on cotton needs to be part of any outcome of the 10th Ministerial Conference in Nairobi (see below). With regard to public stockholding for food security purposes, according to Adank, despite the signs of willingness to engage, it still remained unclear how far Members would be ready to go. Furthermore, it remained to be seen how the proposed provisions for special and differentiated treatment (of less developed countries) specified in Bali would be detailed. These planned provisions consist in preferential rules of origin for Least Developed Countries (LDC), an operationalization of the waiver concerning preferential treatment to services and service suppliers of LDCs, duty-free and quota-free market access for LDCs and a monitoring mechanism on special and differential treatment.

Regarding cotton, one has first to consider that there are three activities going on within the WTO: i) a Sub-Committee of the agriculture negotiations (set up in November 2004), ii) dedicated discussions on the trade situation "in the context of" the agriculture negotiations (set up by the December 2013 Bali Ministerial Conference), and iii) meetings on development aspects of the sector (the "Director-General's Consultative Framework Mechanism on Cotton"). With regard to negotiations, Ambassador Adank suggested that a specific outcome on export subsidies in the area of cotton could be envisaged in the context of a wider outcome in the export competition pillar. On market access, he noted that the objective is to achieve duty free and quota free access for cotton exports from least-developed countries (LDCs) to developed countries and to increase import opportunities in developing countries. On domestic support, Ambassador Adank admitted that the overall situation in the agriculture negotiations remains uncertain, "but the overall uncertainty should not hide the fact that a specific domestic support outcome on cotton should be part of any final outcome in the Doha Round negotiations". To support the negotiations, the United States announced that on 29 June 2015 it had extended its Generalised System of Preference scheme, allowing the relevant legislative authority to eliminate import duties on cotton imports from LDCs on five additional tariff lines. The measure was expected to enter into force in October.

The outcome of the Nairobi Ministerial Meeting fell below the already limited expectations articulated by the outgoing chairman of the agricultural committee. Essentially, paying tribute to the place where the conference took place, a package for LDC's concerns was adopted, with limited content.[44] The Nairobi Package contains a series of six Ministerial Decisions on agriculture, cotton and issues related to least-developed countries. These include a commitment to abolish export subsidies for farm exports, which Director-General Roberto Azevêdo hailed as the "most significant outcome on agriculture" in the organization's 20-year history. The other agricultural decisions cover public stockholding for food security purposes, a special safeguard mechanism for developing countries, and measures related to cotton. Decisions were also made regarding preferential treatment for least developed countries (LDCs) in the area of services and the criteria for determining whether exports from LDCs may benefit from trade preferences.

According to the Ministerial Decision on Export Competition (WT/MIN(15)/45), developed members have committed to remove export subsidies immediately, except for a handful of agriculture products, and developing countries will do so by 2018. Developing members will keep the flexibility to cover marketing and transport costs for agriculture exports until the end of 2023, and the

[43] The most contentious point is whether imports benefitting from bilateral free trade agreements can be counted against the minimal imports that have to be let in at the in-quota tariff rate.

[44] The following paragraphs are essentially taken from https://www.wto.org/english/news_e/news15_e/mc10_19dec15_e.htm

poorest and food-importing countries would enjoy additional time to cut export subsidies. The decision contains also disciplines to ensure that other export policies are not used as a disguised form of subsidies. These disciplines include terms to limit the benefits of financing support to agriculture exporters, rules on state enterprises engaging in agriculture trade, and disciplines to ensure that food aid does not negatively affect domestic production. Developing countries are given longer time to implement these rules.

The Ministerial Decision on Public Stockholding for Food Security Purposes (WT/MIN(15)/44) commits members simply to engage constructively in finding a permanent solution to this issue. Under the Bali Ministerial Decision of 2013, developing countries are allowed to continue food stockpile programmes, which are otherwise in risk of breaching the WTO's domestic subsidy cap, until a permanent solution is found by the 11th Ministerial Conference in 2017.

The Ministerial Decision on a Special Safeguard Mechanism (SSM) for Developing Countries (WT/MIN(15)/43) recognizes that developing members will have the right to temporarily increase tariffs in face of import surges by using an SSM. Members will continue to negotiate the mechanism in dedicated sessions of the Agriculture Committee.

The decision in Nairobi on enhanced opportunities for least-developed countries' export of goods to both developed and developing countries under unilateral preferential trade arrangements in favour of LDCs builds on the 2013 Bali Ministerial Decision on preferential rules of origin for LDCs. The Bali Decision set out, for the first time, a set of multilaterally agreed guidelines to help make it easier for LDC exports to qualify for preferential market access. The Nairobi Decision expands upon this by providing more detailed directions on specific issues such as methods for determining when a product qualifies as “made in an LDC,” and when inputs from other sources can be “cumulated” — or combined together — into the consideration of origin. It calls on preference-granting members to consider allowing the use of non-originating materials up to 75% of the final value of the product. The decision also calls on preference-granting members to consider simplifying documentary and procedural requirements related to origin.

The Ministerial Decision on Implementation of Preferential Treatment in Favour of Services and Service Suppliers of Least Developed Countries and Increasing LDC Participation in Services Trade (WT/MIN(15)/47) extends the current waiver period under which non-LDC WTO members may grant preferential treatment to LDC services and service suppliers. The period has been extended 15 years until 31 December 2030. The waiver allows WTO members to deviate from their most-favoured nation obligation under the General Agreement on Trade in Services (GATS). To date, 21 members have submitted notifications granting preferences to LDC services and service suppliers.[45] The decision also instructs the WTO's Trade in Services Council to encourage discussions among members on technical assistance aimed at increasing the capacity of LDCs to participate in services trade. It also sets up a review to monitor the operation of the notified preferences.

The Ministerial Decision on Cotton (WT/MIN(15)/46) addresses market access, domestic support and export competition. On market access, the decision calls for cotton from LDCs to be given duty-free and quota-free access to the markets of developed countries — and to those of developing countries declaring that they are able to do so — from 1 January 2016 (see above the step made by the US on 29 June 2015 adding five lines to its LDC preference scheme). On export competition for cotton, the decision refers to the Ministerial Decision on Export Competition (see above) and mandates that developed countries prohibit cotton export subsidies immediately and developing countries do so at a later date. Disappointingly, the domestic support part of the cotton decision acknowledges simply members' reforms in their domestic cotton policies and stresses that more efforts remain to be made.

Ministers also adopted decisions covering i) a Work Programme on Small Economies; ii) a continued freeze on TRIPS Non-violation and Situation Complaints,[46] and iii) a continued Work Programme on Electronic Commerce. In this area it was decided to prolong the existing “moratorium”

[45] The EU scheme, a document of 96 pages, may be consulted under http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015D2108

[46] The TRIPS Agreement contains a temporary restraint (a “moratorium”) on bringing non-violation complaints to the WTO's dispute settlement system. Such complaints can be raised if countries feel that another government’s action or a specific situation has deprived it of an expected benefit, even if no agreement has literally been violated. The United States and Switzerland continue to argue that there is a place for non-violation complaints in TRIPS while most other members disagree. In November 2015, the moratorium has once more been extended to the next Ministerial Conference.

on imposing customs duties on electronic transmissions decided at the Bali Ministerial Conference in December 2013 to the 11th Ministerial Conference in 2017.

Given the limited advancement in agricultural negotiations, the result achieved in non-agricultural market access was all the more praised. Under the expanded WTO Agreement on Trade in Information Technology Products, import duties will be eliminated on 201 high-tech products with an estimated annual trade volume of US-$ 1.3 trillion, accounting for approximately 10 per cent of world trade in goods. Products covered include i.a. touch screens, GPS navigation equipment and medical equipment such as magnetic resonance imaging products. Some of the products covered by the ITA Expansion have relatively high import duties in certain key markets. For instance, tariffs on certain parts of telephone handsets are 8.5%; video game consoles and DVD recorders are 14%; compact disc players are 30%; and video cameras are 35%. 95.4 per cent of Participants' imports on these products will benefit from duty-free treatment by 2019. Negotiations were conducted by 24 Participants, which represent 53 WTO Members, including both developed and developing WTO Members, and account for approximately 90 per cent of world trade in these products. In spite of the fact that the ITA Agreement of 1996 is a plurilateral agreement, the 53 WTO Members that are participating in the ITA expansion will record their commitment in their WTO tariff schedule which means that the MFN principle applies so that all 162 WTO Members will benefit from zero tariffs. The ITA Expansion agreement contains also a commitment to work to tackle non-tariff barriers in the IT sector, and to keep the list of products covered under review to determine whether further expansion may be needed to reflect future technological developments.

This success should not occult that at the end of the Nairobi Conference, Ministers acknowledged that members “have different views” on how to address the future of the Doha Round negotiations but noted the “strong commitment of all Members to advance negotiations on the remaining Doha issues.” WTO General Director Roberto Azevêdo was more sceptical and remarked “persistent and fundamental divisions on our negotiating agenda” and said WTO members “have to face up to this problem.” These declarations reflect a divide between the industrialised nations and emerging economies, the former seeking to put new themes linked to globalisation on the negotiating agenda while the latter have an interest in maintaining provisions giving preferential treatment to developing countries, also the more advanced ones. On the background of these divergent views, agricultural negotiations will continue to proceed, if at all, only in a lentous way.

Chapter 2

Additional Features of the Agricultural Trade Regime

The WTO rules affecting specifically the agricultural sector are much more comprehensive than the previous chapter suggests where the emphasis was on subsides for a specific crop and a particular litigation linked to this commodity. Some of the additional features we will immediately take up are of particular importance when countries intend to process agricultural products grown on their soil. Conditions for FDI by food processing multinational companies in the production region of a primary input are therefore a major focus below.

1 Tariff escalation

Politics at the end of the 19th century are placed under the heading of imperialism. The emerging national states were seen in fierce competition for markets. To be successful, sourcing for the national industries needed to be as cheap as possible. By conquering new colonies, the provision of raw materials could be secured. At the same time, export markets could be gained. To further support national industries, tariff escalation became also prominent. Tariff escalation means that import duties are the higher the further processed the imported good is. Despite seven negotiating rounds of tariff reduction in the period after WWII up to the constitution of the WTO in 1995, tariff schemes are still marked by tariff escalation. The tariff scheme applicable to a product for which Switzerland is worldwide renown, namely chocolate, is a telling example. To better understand the case, one has to consider that Swiss chocolates are only typical for the country to the extent that Swiss chocolate traditionally has a comparatively high content of milk. But evidently, cocoa – giving the product its name – is a tropical fruit and cannot be grown in the industrialised world. It is a major export product of tropical countries.

The classification of cocoa and cocoa products in the Harmonized System

18.01	1801.00	**Cocoa beans, whole or broken, raw or roasted.**
18.02	1802.00	**Cocoa shells, husks, skins and other cocoa waste.**
18.03		**Cocoa paste, whether or not defatted.**
	1803.10	-Not defatted
	1803.20	-Wholly or partly defatted
18.04	1804.00	**Cocoa butter, fat and oil.**
18.05	1805.00	**Cocoa powder, not containing added sugar or other sweetening matter.**
18.06		**Chocolate and other food preparations containing cocoa.**
	1806.10	-Cocoa powder, containing added sugar or other sweetening matter
	1806.20	-Other preparations in blocks, slabs or bars weighing more than 2 kg or in liquid, paste, powder, granular or other bulk form in containers or immediate packings, of a content exceeding 2 kg
		-Other, in blocks, slabs or bars :
	1806.31	-- Filled
	1806.32	-- Not filled

Cocoa can be imported in the form of beans, but cocoa can also be imported in a processed form, in particular as cocoa butter. Heading 18 of the Harmonised System is structured along the process of transforming cocoa into chocolate. Switzerland has, as other countries, additionally subdivided the 'escape' 6-digit tariff position 1806.90 (not shown in the official table but admitted for all tariff lines by the HS) for preparations containing cocoa, in packages below 2kg, and not in form of blocks, slabs or bars. Most imports under heading 18 into Switzerland fall actually under the escape heading ".90" where sachets for chocolate drinks, Pralinés and the like are ranged. [47]

The table on the next page shows imports and applicable tariffs for cocoa and cocoa products into Switzerland. Note that tariffs in Switzerland are "specific", i.e. they are per 100kg,[48] not "ad valorem", i.e. fixed as a percentage of the value of the imports.[49] The situation as revealed in the table is easy to understand: In accordance with the idea that industries should have raw materials as cheap as possible, beans (18.01) are not subject to any tariffs. Cocoa waste (18.02, not in the table as there are quasi no imports) which may serve feeding purposes, is subject to a so called nuisance duty of SFR -.60 when imported according to MFN rules, a rate that is reduced to 0.- if it effectively serves as foodstuff, thus serves as a primary input the interest of peasants. Cocoa paste (18.03) is also omitted from the table as imports are negligible. Cocoa butter, fat and oil (18.04), a somewhat more elaborate input for the food processing industry, is subject to a MFN tariff rate of 2.-. A first substantial increase in the tariff rate affects cocoa powder, where the rate is Fr. 20.-. The housewife baking chocolate cakes is therefore already taxed, but not when the provisioning is done in the EU or another country with which Switzerland has a preferential tariff scheme.

Tariff escalation is evident once we consider the consumer product. In order to shield milk farmers, also imports from the EU under heading 1806 have to pay a tariff, as the Free Trade Agreement of Switzerland with the EU does only partially integrate agricultural markets. We indicate only the tariff applicable to chocolate in bars where imports of some SFR 35 mio. occurred in 2013, quasi exclusively from the EU/EFTA. Abstracting from imports under 1806.90, where rates in the same range apply, this is the most important tariff position within 18.06. To give a feeling for the importance of a tariff of SFR 50.- per 100kg, consider that the tariff applied to a chocolate bar of 100g amounts to 5 cents (MFN-rate) and that a bar costs below SFR 2.- in retail stores. The importance of the tariff only appears once one considers that the out of factory price of a chocolate bar is consequently[50] below SFR 1.- and that domestic and foreign producers buy cocoa beans at the same price. Furthermore, profits expressed as a percentage of turnover of 10% are appreciated by many industries. One may therefore conclude that unless an exporting country has cost advantages in manufacturing over Switzerland of 10% or more, imports of standard chocolate bars are made uninteresting by the tariff.

What is not shown in the table is the complexity of the tariff scheme for chocolate. The HS scheme foresees to eventually distinguish between chocolate in bulks and chocolate in bars, the former being of interest e.g. to small-sized chocolate producers such as bakery's, while the latter is of direct interest to the consumer. Countries are free to introduce subdivisions within HS 6-digit positions, and Switzerland benefits from this possibility. For imports for industrial purposes, i.e. imports with packaging size above 2kg, Switzerland has 17 subdivisions of the 6-digit HS-number 1806.20. Within 1806.20, the tariffs for chocolate and other preparations containing cocoa go down from SFR 727.20 to SFR 10.- per 100kg in accordance with the content of milk fat, an eventual presence of other components of milk than milk fat above 20% and the content of other fats (e.g. palm oil). The SFR 727.20 apply to mixtures containing cocoa with a milk fat content >85% while the SRF 10.- apply when neither milk fat or other components of milk nor other fats are present. The purpose to protect milk farmers is clearly brought out by this fine-tuned scheme. Not surprisingly, imports of chocolate in bulk remain anecdotal in the range where tariffs above SFR 100.- per 100kg apply.

[47] The HS Nomenclature comprises about 5,000 commodity groups which are identified by a 6-digit code. The Combined Nomenclature of the European Union (EU) integrates the HS Nomenclature and comprises additional 8-digit subdivisions and legal notes specifically created to address the needs of the Community. http://ec.europa.eu/taxation_customs/customs/customs_duties/tariff_aspects/harmonised_system/index_en.htm

[48] Usually, gross weight is applicable, for imports from the EU usually the net mass applies.

[49] Switzerland is an exception in having since 1848 a tariff scheme knowing exclusively specific duties. In the area of agricultural products the situation is not as exceptional, however, since many countries combine here ad valorem duties with specific tariffs, the latter acting – within a tariff position – better against cheap imports.

[50] For trade margins see Chapter 10, part II in the underlying publication.

Imports of Switzerland of cocoa and chocolates in 2013

18	Cocoa and Chocolate SFR	share of total imports from region	unit value	tariff
Total	487,867,746	0.27	4.28	MFN-rate
non-oil DC	85,144,397	1.92	2.84	GSP-Rate
Ghana	57,294,974	84.90	2.81	GSP-Rate
EU+EFTA	363,781,700	0.28	5.05	EU-Rate

1801	Cocoa Beans SFR	share of HS18-imports out of the region	unit value	tariff
Total	118,666,769	24.32	2.90	0.-
non-oil DC	82,104,146	96.43	2.80	0.-
Ghana	55,460,790	96.80	2.78	0.-
EU+EFTA	1,305,191	0.36	4.91	0.-

1804	Cocoa Butter SFR	share of HS18-imports out of the region	unit value	tariff
Total	111,042,354	22.76	3.86	2.-
non-oil DC	566,465	0.67	5.55	0.-
Ghana	25	0.00	5.00	0.-
EU+EFTA	109,455,760	30.09	3.84	0.-

1805	Cocoa Powder	share of HS18-imports out of the region	unit value	tariff
Total	18,117,366	3.71	3.99	20.-
non-oil DC	1,953,994	2.29	4.11	0.-
Ghana	1,832,630	3.20	4.10	0.-
EU+EFTA	15,611,968	4.29	3.95	0.-

1806	Chocolate SFR	share of HS18-imports out of the region	unit value	tariff (position 1806.3111)
Total	223,391,308	45.79	6.43	50.55
non-oil DC	182,102	0.21	19.27	40.55
Ghana	1,529	0.00	10.54	40.55
EU+EFTA	221,173,409	60.80	6.41	35.05

They are also negligible when other fat than milk fat is present in bulk imports, a feature that is common in foreign chocolate as cheaper palm oil is substituted for cocoa butter. Therefore, some protection of the traditions of Swiss chocolate manufactures is also evident in the scheme. The fine-tuned scheme of course extends also to chocolate and preparations of cocoa in the size the end consumer buys, since 16 subdivisions of the relevant HS 6-digit positions 1806.31, 1806.32 and 1806.90 exist.

In the area of chocolate (1806), the preference margin over MFN-rates is often negligible, frequently only SFR 1.- per 100kg, the tariff position 1806.3111 shown in the table constituting rather an exception, perhaps reflecting offensive interests of Swiss chocolate manufacturers.[51]

Switching from tariffs to import structures, the traditional idea that Africa is exporting unprocessed food is clearly confirmed. 85% of Swiss imports from Ghana fall in HS position 18 (cocoa and chocolate) and of this amount 97% or 55mio are in the form of cocoa beans. Note that 30% of imports from EU/EFTA are in the form of cocoa butter, and that no tariffs apply to these imports, neither from the EU/EFTA, nor the countries benefitting from the Generalised System of Preferences (GSP; as Ghana) or other free trade partners of Switzerland. Adding within Ghana a next step in processing cocoa by transforming it into cocoa butter would therefore not face protectionisms in the case of Switzerland and, considering the imports from EU/EFTA, a market would be there. Ivory Coast, sending cocoa beans for SFR 17mio to Switzerland[52], would as a LDC (Least Developed Country) benefit from a tariff of 0.-even in the position 1806 (where consumer and elaborate intermediate cocoa products range), but imports of final consumer products are - as in the case of Ghana - quasi nil (SFR 10'000.- in 2013).

These figures can serve as a background for the next subchapter where WTO-rules regarding tropical products are taken up. The subchapter addresses also special and sensitive products, highly contentious issues in the Doha Development Round.

2 Tariff negotiations in the Doha Development Round

The first negotiating round under the auspices of the World Trade Organisation, the Doha Development Round launched in 2001, has - similar to the prior negotiating rounds under the GATT - the reduction of tariff rates as one major objective. A reduction objective is particularly justified with regard to agricultural tariffs since these still reach frequently values seriously inhibiting if not prohibiting trade. Given the huge number of tariff lines and the number of countries participating in the negotiations, general principles had to be established to reach an agreement on tariff reduction. These general principals consist essentially in agreeing on a formula for tariff reduction that applies across the board plus a number of provisions that serve either the development objective that figures in the title of the negotiating round or the political difficulties single countries may have when their shielded sectors would be exposed to tariff reduction according to the standard formula on which countries will agree.

In the paragraphs that follow, we will address the question of the formula that should apply across the board, special provisions favouring developing countries, namely tropical and special products, and the provisions attenuating the consequences the general formula might have on specific sectors in specific countries. For the latter, the notion "sensitive products" was coined. Finally, the concept of 'like products' will be taken up although the provision regarding "like products" is a general principle within GATT and has no direct relation with the Doha negotiating round. It has particular importance in areas where a destination country intends to impose sanitary and phyto-sanitary prescriptions on imports. The link with tariff reduction is indirect. Non-tariff barriers to trade (NTMs), and in particular technical obstacles to trade (TBTs) may serve as a substitute when tariff protection falls away or is significantly reduced. At the same time, NTMs and in particular TBTs cannot be set to zero as tariffs could be, since they serve, if not abused, acknowledged public interests. The appropriate approach with respect to NTBs is to make them as trade-friendly as possible.

At an early stage of Doha Development Round negotiations, Joseph Francois from the Tinbergen Institute gave some thoughts to formula approaches for market access negotiations.**[53]** The next subsection takes them up.

The framework for the tariff negotiations in the Doha Development Round

Problems arise right at the start when defining the target of the negotiations: shall there be an average cut across all tariff lines or a cut in the average tariff? Clearly,**[54]** if the average cut per tariff

[51] Offensive interests reflect situations where in a negotiation export interests predominate over the protection of the domestic market.

[52] 88% of beans imported into Switzerland come either from Ghana or the Ivory Coast but this may change as chocolate bars with high cocoa content are increasingly branded by country of origin.

[53] Francois, Joseph (2002): Formulas for Success? Some Options for Market Access Negotiations, International Trade 0210001, EconWPA

[54] In principle, the "clearly" is everything else but clear; it arises out of the negotiators attitude to consider any tariff reduction as a "concession". From a legalistic point of view this is not wrong: The national legislator is restricted in rising tariff protection. From an economists point of view, the

line is the criterion and the trade volume per line is disregarded, cuts will be operated in chapters where lines are numerous and trade per tariff line small. The number of subdivisions should be irrelevant with the proposed formula, however, pleading for a cut in the average tariff.

A second point of importance is the wide dispersion in the tariff schemes of the WTO members at the outset of the negotiations. With the implementation of the Uruguay Round commitments, average ad valorem tariffs in the industrial countries fell generally to around 3 percent for industrial products. However, there are important exceptions within the chapters 25 to 99 of the HS. One of these is textiles and clothing, where the average rate is roughly three times this average. The idea to make the final step and to set tariffs at zero could therefore only be realized in the area of the Information Technology Agreement (ITA). A formula approach was also needed for non-agricultural market access (NAMA).

In exchange for the tariff reductions granted in agriculture, the developed countries want to see improved access to developing countries' markets for industrial goods. The level and dispersion of tariff rates for industrial products is however low compared to the situation prevailing in the agricultural sector. Furthermore, in the agricultural sector, gaps between applied rates and tariff bindings are particularly wide. This so-called 'binding overhang' resulted from "dirty tariffication" or the use of "ceiling bindings" in the Uruguay Negotiations where, an innovation over the Tokyo Round, agricultural tariffs had to be bound. This was often done well above the applied rates of the time. Accordingly, the author concludes that any approach to negotiating market access in agriculture will have to deal with both tariff bindings and quantity commitments in order to open effective market access. Countries should not be in apposition to sell only hot air, namely the binding overhang. One size fits all is thus not possible for access to agricultural and non-agricultural markets.

A potentially serious problem is also created by specific, mixed and compound tariffs, where the agricultural sector again stands out by the frequency with which such complex tariff structures are used. To convert all specific tariffs to ad valorem form prior to applying the formula is indispensable, but the conversion in itself already shifts competitive positions.[55]

The formula applied across the board

A formula applied across the board can achieve two objectives: (i) it can ensure a balanced exchange of concessions and (ii) if appropriately chosen, it can reduce relatively high barriers by more than lower barriers. With regard to (i), a formula approach has the advantage that it reduces the ability of individual firms and sectors to lobby for the retention of protection that benefits them at the expense of the broader social interest. With regard to (ii), it holds true that the social costs of tariffs generally rise more rapidly than the rates themselves although the presence of non-produced intermediates weakens this general proposition.[56] Indeed, little reduction was achieved in the four negotiation rounds after the initial tariff reduction negotiations in GATT since in these rounds the negotiations happened line by line and the cuts often spared the high range. Only the next round, the Tokyo Round (1974-1979), using a more sophisticated formula, the so-called Swiss formula, achieved a 30 percent reduction in average tariffs.[57] This formula looks as follows:

$$t_1 = r^* t_0 / (r^*+t_0),$$

where t_1 is the tariff rate resulting after application of the formula, r^* is a positive tariff rate which will function as a ceiling on tariff rates after negotiations, and t_0 is the (bound) rate at the outset of the negotiations. The Tokyo Round value of the parameter r^* was in the range of a 14% to 16% tariff. For an extremely small initial tariff, say one tenth of one percent, $r^*/(r^*+ t_0)$ in equation (8) is essentially one, implying no reduction in the tariff. For an initial tariff rate in the range of r^*, the final tariff rate is in the range of half of r^*, implying a 50 percent reduction from the initial tariff. For a

idea of "concession" is the expression of a protectionist, pro-producer attitude (although, as explained in the section on tariff escalation, producers down the value added chain share the interest of consumers).

[55] A specific tariff is the lower the higher the value per kg of an import is. High end producers of a specific product therefore suffer less from a specific tariff than low end producers. Specific tariffs can also lead to the fact that tariff protection, calculated as total tariff revenue divided by total import value, can go up without any tariff changes being decided. This is the case when prices decline or the weight of products performing a certain task goes down as a consequence of technical progress.

[56] For more information see the literature indicated in the article resumed.

[57] The Uruguay Round (1986-94) used a simpler approach involving setting broad tariff-reduction goals such as a 30 percent average reduction on industrial products, but leaving the distribution of the cut across sectors up to negotiations between trading partners. The Uruguay Round was generally not successful in achieving higher proportional cuts in higher tariff rates and hence in sharply reducing tariff escalation.

very high initial tariff, $t_0/(r^*+ t_0)$ is effectively one and the tariff rate is essentially reduced to r^*.[58]

It was clear from the experience of prior negotiating rounds that a pure Swiss formula would not provide sufficient flexibility for all WTO members to reach agreement on tariff reductions under the Doha Development Agenda. One possible approach to dealing with this would have involved the application of a Swiss-type tariff reduction, guided by targeted reductions in the average tariff, rather than a common Swiss formula parameter r^*. Possibly, the latter could have been fixed by sector. Finally, a solution with bands was chosen (see below). This solution still reflects the idea enshrined in the Swiss formula, namely that high rates should be cut by more than low rates.

The proposal which is since end 2008 on the table[59] reads as follows: "Developed country Members shall reduce their final bound tariffs in six equal annual instalments over five years in accordance with the following tiered formula: (a) where the final bound tariff or ad valorem equivalent is greater than 0 and less than or equal to 20 per cent, the reduction shall be 50 per cent; (b) where the final bound tariff or ad valorem equivalent is greater than 20 per cent and less than or equal to 50 per cent, the reduction shall be 57 per cent; (c) where the final bound tariff or ad valorem equivalent is greater than 50 per cent and less than or equal to 75 per cent, the reduction shall be 64 per cent; and (d) where the final bound tariff or ad valorem equivalent is greater than 75 per cent, the reduction shall be 70 per cent. The minimum average cut on final bound tariffs that a developed country Member shall be required to undertake is 54 per cent.

Special and differential treatment

In order to comply with the requirement that the Doha Round outcome should foresee a special and differential treatment of developing countries, it was accepted that the tariff rate reductions of the latter would be less ambitious. The bands discussed were wider (the forth band e.g. started only at a 130% tariff) and the cuts smaller (in the fourth band, the cut would only be two thirds of those ordinarily requested in this range). Furthermore, these countries should have been allowed to keep the overall tariff rate cut below a threshold of 36 per cent. One may note that this would not have been the only articulation of special and differential treatment.

Least-developed country members are also specifically addressed in the proposal of 2008. They are not required to undertake reductions in bound duties. Furthermore, the Decision on Measures in Favour of Least-Developed Countries of the Hong Kong Ministerial Declaration is recalled in the modalities. Accordingly, developed members shall, and developing country members declaring themselves in a position to do so should:

(a) (i) provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs no later than the start of the implementation period in a manner that ensures stability, security and predictability. (ii) members facing difficulties at this time to provide market access as set out above shall provide duty-free and quota-free market access for at least 97 per cent of products originating from LDCs, defined at the tariff line level, no later than the start of the implementation period. In addition, these Members shall take steps to progressively achieve compliance with the obligations set out above, taking into account the impact on other developing country Members at similar levels of development, and, as appropriate, by incrementally building on the initial list of covered products. (iii) Developing country Members shall be permitted to phase in their commitments and shall enjoy appropriate flexibility in coverage.

(b) Provide meaningfully enhanced market access for all LDCs.

(c) Ensure that preferential rules of origin applicable to imports from LDCs will be transparent, simple and contribute to facilitating market access in respect of agricultural products.

This is also the place to indicate that under certain conditions, vulnerable economies[60] would be entitled to moderate the cuts by a further 10 ad valorem percentage points in each band, while recently-acceded members would be allowed to moderate the cuts by up to 8 ad valorem percentage points. Saudi Arabia, the Former Yugoslav Republic of Macedonia, Viet Nam, Tonga and Ukraine were generally exempt.

[58] In the Doha negotiations, the Swiss negotiators would not at all be enchanted to see the Swiss formula applied.

[59] Henceforward quoted as the "modalities". They reflect the chairperson's proposals for an agreement in agriculture as of December 2008. See https://www.wto.org/english/tratop_e/agric_e/chair_texts08_e.htm

[60] The term applies to members with economies that, in the period 1999 to 2004, had an average share of (a) world merchandise trade of no more than 0.16 per cent or less, and (b) world trade in non-agricultural products of no more than 0.1 per cent and (c) world trade in agricultural products of no more than 0.4 per cent.

Sensitive products, the escape line

In order to offer countries which are facing heavy resistance of at least some sectors to the foreseen tariff cut an escape line was foreseen, i.e. exceptions for particular, so called “sensitive” products were allowed, but linked to the requirement of an enhanced market access granted through tariff quotas.[61] We only consider here the requirements for developed countries, the requirements for developing countries being again less ambitious and more differentiated (in particular, developing country members shall have the right to designate up to one-third more of tariff lines as sensitive products).

Relevant provisions read: Each developed country member shall have the right to designate up to 4 per cent of tariff lines as "Sensitive Products". Where such members have more than 30 per cent of their tariff lines in the top band, they may increase the number of sensitive products by two per cent. The deviation in the required tariff cut may be one-third, one-half or two-thirds of the reduction that would otherwise have been required by the tiered reduction formula. In principle, all of the tariff lines for a particular product shall take a uniform deviation. For developed countries, the compensation in form of tariff quotas shall result in new access opportunities equivalent to no less than 4 per cent of domestic consumption expressed in terms of physical units where the two-thirds deviation is used (3.5% when the deviation is one-half and 3% when the deviation is one-third). In-quota tariffs shall be reduced either by 50 per cent or to a threshold of 10 per cent, whichever results in the lower tariff.

The modalities then contain a series of additional provisions. They address rates that remain over 100%, tariff quotas which are already large compared to domestic consumption, tariff escalation, commodities, tariff simplification, tariff quota administration and notification, and unfilled quotas.

Special Products and the Special Safeguard Mechanism

While it is widely recognised that developing countries as a whole would benefit from freer agricultural trade, some fear that most of the new opportunities the Doha Round is set to bring would be captured by a few middle-income countries and large food exporters. Lower income countries in particular are concerned that domestic rural populations employed in import-competing sectors might be negatively affected by further trade liberalisation, becoming increasingly vulnerable to market instability and import surges once tariff barriers are reduced.[62] Many of these countries indeed have large rural populations composed of small farmers with few employment alternatives, operating with deficient equipment and lacking access to infrastructures and correspondingly to processing facilities and markets. These concerns were first raised at the WTO in the context of the “Development Box” debate, in which developing countries tabled a set of proposals aimed at providing flexibility for countries to enhance domestic food production and adopt measures to protect the livelihoods of resource poor farmers. In particular, provisions on “Special Products” should provide targeted protection for selected products which would not survive under competitive conditions but are crucial for food security, livelihood security and rural development. Additionally, a “Special Safeguard Mechanism” would allow countries to protect import-competing sectors (including well-established ones) against import surges and/or price depression.[63] The modalities of 2008 take these two proposals up as we will immediately show.

Special Products: According to the modalities of 2008, developing countries should be entitled to self-designate “Special Products” guided by indicators based on the criteria of food security, livelihood security and rural development. There shall be 12 per cent of tariff lines available for self-designation as Special Products. Up to 5 per cent of lines may then have no cut. The overall average cut shall, in any case, be an eventual 11 percent. Again, vulnerable and recently acceded countries are specially addressed. The relevant Articles of the Agreement on Agriculture shall be amended to reflect the above modalities. The exact figures remained contested, however.

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[61] A tariff rate quota is a commitment to allow imports making up a certain share of the domestic market at significantly lower tariffs than the MFN rates.

[62] In the space of a few years, Honduras went from being self-reliant in rice to importing almost half of domestic consumption, since locally-produced rice was undercut by cheaper imports from Southeast Asia. In Senegal, tomato paste imports skyrocketed after liberalisation in 1994, while domestic production fell by half. The report quoted in the following footnote gives other examples and provides six case studies on the issue.

[63] More indications may be found in International Centre for Trade and Sustainable Development (ICTSD) (2005): Special Products and the Special Safeguard Mechanism - Strategic Options for Developing Countries, Issue Paper No.6, Geneva. http://www.ictsd.org/themes/agriculture/research .

The Special Safeguard Provisions (SSG) in the Agriculture Agreement: Safeguards are contingency restrictions on imports taken temporarily to deal with special circumstances such as a sudden surge in imports. They normally fall under the Safeguards Agreement, but the Agriculture Agreement has special provisions (Article 5) on safeguards. In agriculture, unlike with normal safeguards, higher safeguards duties can be triggered automatically when import volumes rise above a certain level, or if prices fall below a certain level; and it is not necessary to demonstrate that serious injury is being caused to the domestic industry. The special agricultural safeguard can only be used on products that were 'tariffied' (i.e. where import quotas were transformed in equivalent tariffs) — which amount to less than 20% of all agricultural products (as defined by "tariff lines"). But they cannot be used on imports within the tariff quotas, and they can only be used if the government reserved the right to do so in its schedule of commitments on agriculture. Beyond the industrialised countries, this was only done by some 20 countries, many others not having 'tariffied' essential agricultural products. In practice, the special agricultural safeguard has been used in relatively few cases.[64] Amplified binding of agricultural tariffs and the fact that tariff reductions would compress the margin between bound and applied rates, however, making specific agricultural safeguards more important if an agreement in the Doha round were reached.

To replace the SSG by a new safeguard mechanism, the SSM (see below), remained contested.[65] Rather, the request of many developing countries is to rebase the price trigger of the SSG to a more recent and representative period given that the Uruguay Round SSG price trigger was based on import prices that prevailed more than 20 years ago.

The 2008 proposal for a Special Safeguard Mechanism (SSM): The SSM as discussed in 2008 would have no a priori product limitations as to its availability, i.e. it could be invoked for all tariff lines in principle. A price-based and a volume-based SSM would be available. As regards the volume-based SSM, it would be applied on the basis of a rolling average of imports in the preceding three-year period. On this basis, a schedule of applicable triggers and remedies would be applied. The discussed schedule foresees at the first stage that where the volume of imports during any year exceeds 110 per cent but does not exceed 115 per cent of base imports, the maximum additional duty that may be imposed on applied tariffs shall not exceed 25 per cent of the current bound tariff or 25 percentage points, whichever is higher. The corresponding figures in the 115-135% band are 40 per cent and above 135% the addendum would be 50 per cent. As regards the price-based SSM, it would be applicable where the c.i.f. import price of the shipment expressed in domestic currency falls below a trigger price equal to 85 per cent of the average monthly MFN-sourced price for that product for the most recent three-year period preceding the year of importation This rule is subject to a complement for the case of a significant devaluation of the country's currency. Also, the additional duty is limited to 85% of the difference of the import and trigger price and the SSG should not be applied when imports are regressing. Volume and price based safeguards shall also not be available when import volumes are manifestly negligible so that they cannot undermine the domestic price. A number of additional conditions and provisions figure also in the modalities. The Agreement on Agriculture would be amended to reflect the outcome of the negotiations.

The negotiations on the SSM are stalled, however. In fact, already to update the base year for the SSG in place remains disputed. In the Ministerial Conference in Nairobi in December 2015 it was only decided that members will continue to negotiate the mechanism in dedicated sessions of the Agriculture Committee.

Tropical products[66]

The treatment of tropical products remained a contested topic in 2008 in Hong Kong. One proposal was that for the products listed in Annex G od the modalities, the tariff should be set to zero where the scheduled tariff is less than or equal to 25 per cent ad valorem, and above the cut should be 85 per cent. There should also be no sensitive product treatment for any of the products appearing on the list. However, a counterproposal was also in discussion, and the situation was further complicated by the fear of established producers of a preference erosion. 'Preference erosion' means that currently existing tariff advantages, such as an exemption for LDC, provide a smaller advantage on export markets when producers formerly paying MFN-rates (such as middle-income countries) will benefit from the provisions regarding tropical products. The proposal was therefore enhanced by a provision to attenuate

[64] Text taken from https://www.wto.org/english/tratop_e/agric_e/negs_bkgrnd11_ssg_e.htm

[65] See e.g. the Philippines: http://www.wto.org/english/tratop_e/dda_e/meet08_stat_phl_21jul_e.doc

[66] Full title is 'tropical and diversification products'. One goal is to offer smallholder farmers in regions where marijuana, opium and other drugs are grown alternatives.

the possible loss of long-standing preferences. For products listed in an Annex H, no tariff cuts on the items in that list should happen for 10 years, but here again there was also a counter-proposal.[67]

The topic is of immediate relevance for cocoa, since cocoa is a tropical fruit and of the two major exporters, Ghana holds GSP preferences while Ivory Coast is an LDC. We therefore see figure the whole chapter 18 in annex G and cocoa butter, fat, oil and past on list H. Annex G extends the (contested) zero tariff provisions also to chocolate, making it difficult for a country like Switzerland to agree to the proposal regarding this category of products. To figure out that the Alpine Republic would qualify as a major exporter of a tropical product is strange, but from a purely economic point of view the question is whether Switzerland can give up protection for milk producers while possibly gaining better market access in countries where chocolate as a luxury product is exposed to very high tariffs, and this due to a measure which should favour countries located in different latitudes.

Considering this intricate situation, one may question whether the specific proposal for tropical products is mature or whether the provisions applying cross-the-board would not do a better job. Just considering cocoa is insufficient, however, since Annex G covers much more products. Roses, onions, avocados, water melons, mixtures of nuts and dried fruits, coffee and tea, rice, palm oil, potatoes, orange juice and tobacco figure also on the long list. The document presents therefore also the much shorter indicative list of tropical products used in the Uruguay Round, adding the remark that “the resolution of these lists remains under active negotiation at this point”.

Economic significance

In a Policy Research Working Paper of the World Bank,[68] Sebastien Jean, David Laborde and Will Martin examine what the formula applicable across the board and the provisions for sensitive products mean in terms of average tariff rate cuts. Their task is not easy since the draft modalities allow countries a lot of discretion in choosing sensitive products and they are also free to set the deviation. Jean et al. (2010) correctly argue that it would be wrong to anticipate that the highest tariffs would be the most likely to benefit from the flexibility offered by the possibility to designate sensitive products. Very high tariffs can contain a lot of hot air (i.e. the bound rate is considerably over the applied rate) and their volume can be ridiculously small (e.g. garlic imports would have to be chosen).[69] They therefore assume that the agricultural tariff prior to the negotiations results from maximization of a government objective function along the lines of a model proposed by Grossman and Helpman in 1994. The preferences exhibited through the rate structure in place allow them to make a forecast of the tariff lines that would be chosen if the 2008 proposals were adopted. They find that industrial countries, on which we concentrate here, would primarily chose tariff lines afferent to bovine and poultry meat, cut flowers, tomatoes, wheat, raw cane sugar, food preparations n.e.s., fruit and vegetables juices and milk, grape juice, and processed tobacco. The key results they obtain are reproduced below.

The first column indicates average applied tariffs. Among the industrialised nations, Japan and the EFTA countries are the over-protectionist WTO-members in agriculture. The results for the “Formula” scenario are given in the second column of the table. Even though the formulas more than halve average bound tariffs worldwide, the reductions in applied rates are smaller because of the binding overhang. With no sensitive products, the average tariff is cut for industrial countries by -8.5 and for developing countries by -2.5. Considering among the latter only non-LDC WTO members, the reduction goes up to -6.0 percentage points, South Korea among developing countries experiencing also more than a 5 percentage point cut in applied rates. 13 out of the 18 countries and groups of countries shown in Table 1 experience a decline in applied duties of less than four percentage points so that the attenuation by being allowed to single out sensitive products is less important for them.

Allowing two percent of tariff lines to be declared as sensitive (“Sens 2”) cuts the reduction of the average tariff rate for industrialised countries by about half, the EFTA, the EU, Japan and Korea being particularly interested in this alleviation of adjustment needs.

[67] For both counterproposals see the modalities of 2008.

[68] Jean, Sebastien, Laborde, David, Martin, Will (2010): Formulas and Flexibility in Trade Negotiations: Sensitive Agricultural Products in the WTO’s Doha Agenda, Research Working Paper 5200, World Bank.

[69] Their political-economy approach results in a list of most-common sensitive products covering 80 (63) percent of agricultural imports into the industrial (developing) countries, while the highest bound tariff rule leads to a list covering only 5 (7) percent.

Table 1. Implications of Sensitive Products for Reductions in Countries' Average Applied Tariffs

Country (%):	**Base**	**Formula**	**Sens 2**	**Sens 4**	**Sens 2-tariff loss**
Industrial	**14.9**	-8.5	-4.3	-3.8	-4.3
Australia	**3.1**	-1.0	-0.5	-0.5	-0.5
Canada	**9.8**	-5.0	-1.5	-1.0	-1.5
EFTA	**28.9**	-14.2	-7.6	-6.1	-7.5
EU	**13.4**	-7.5	-4.4	-4.0	-4.4
Japan	**35.6**	-22.4	-11.2	-9.9	-11.0
USA	**2.7**	-0.9	-0.4	-0.3	-0.4
Developing	**14.2**	-2.5	-1.2	-1.1	-1.2
ASEAN	**8.9**	-2.3	-0.8	-0.8	-0.8
China	**10.2**	-2.7	-1.8	-1.7	-1.8
India	**55.4**	-3.6	-1.9	-1.8	-1.9
Korea	**27.7**	-10.4	-4.2	-3.6	-4.2
Maghreb	**19.0**	-3.3	-1.7	-1.6	-1.7
Mercosur	**12.8**	-0.2	-0.0	-0.0	-0.0
Mexico	**9.5**	-0.9	-0.2	-0.2	-0.2
Other SSA	**25.3**	-2.0	-0.9	-0.8	-0.9
Pakistan	**31.3**	-0.1	-0.0	-0.0	-0.0
SACU	**12.6**	-0.6	-0.3	-0.3	-0.3
Turkey	**14.1**	-1.1	-0.5	-0.4	-0.4
ROW	**10.3**	-1.8	-1.0	-0.9	-1.0
Non-LDCWTO	**14.6**	-6.0	-3.1	-2.7	-3.0

The study also finds that raising the number of sensitive products to 4 percent ("Sens 4") using the political economy criterion has only a small impact, except in a few cases such as Japan and EFTA. Sheltering just 2% of products is therefore enough to greatly reduce the cut in average tariffs. The column "Sens 2-tariff loss" selects sensitive products by minimizing tariff revenue losses. At the aggregate level, the results using this criterion differ little from those using the authors' political-economy approach. At a disaggregated level, they find that the political-economy criteria pick some products—such as virgin olive oil for the European Union—that seem likely to be treated as exceptions, but are not identified using the tariff revenue loss criterion. Finally, they quote a key finding of Anderson and Neary (2007),[70] namely that increases in the generalised variance of a tariff schedule reduce welfare but will expand market access. The (unclear) provision in the draft modalities that deviations for sensitive products have to be chosen at the product and not the tariff line level may therefore have considerable importance.

The negotiating parties have presumably made further reaching calculations, incorporating e.g. also that to designate sensitive products comes at the cost of having to create tariff quotas. New disciplines on allocating these quotas plus the fixing of the in-quota tariff further modify the result. Calculable partial and general equilibrium models are at disposal to assess the consequence of the 2008 proposal on exports, on domestic production of agricultural and other goods (e.g. through the current account balancing requirement) and on GDP and welfare (also for specific social groups such as farmers). It appears that the negotiating parties have for tactical reasons seldom revealed the results of such calculations. It is also important to keep in mind that tariff rate cuts are certainly important for Japan, South Korea and the EFTA countries, but that for the USA, e.g., other parts of the agricultural negotiations

[70] Anderson, James E. and J. Peter Neary (2007): Welfare versus Market Access: the Implications of Tariff Structure for Tariff Reform." Journal of International Economics 71:187– 205

such as restrictions on domestic support, amber box support, and export promotion matter more.

Like products (and Processing or Production Measures (PPM))

As explained above, like products are not an additional category to tropical, specific or sensitive products. The notion of 'like products' emerges as an expression of a fundamental principle of GATT, namely the principle of non-discrimination. Legal provisions shall not distinguish between like products, a guiding principle by which – first of all – distinctions based on the foreign or domestic origin of a product are banned.

It is to be decided on a case by case basis whether products that have different physical characteristics are 'like products' because they serve the same purpose. In the asbestos case, the Appellate Body decided that products containing asbestos are different to e.g. products made of glass fibre; although both may serve as roof coverings or flower boxes. The different "risk" to health due to their different physical characteristics makes them distinct. So the usage made of a product is not the only criterion in assessing "likeliness".

The question becomes more delicate when products should be treated differently because of the way in which they have been produced even if the production method used does not leave a trace in the final product, i.e. even if the physical characteristics of the final product remain identical. An arising inconsistency with Article XI of GATT may then eventually be justified by Article XX, General Exceptions, provided the provisions are necessary to protect an established public interest, are not applied arbitrarily and do not constitute a disguised restriction on international trade.

In a case brought to the Appellate Body, the U.S. were allowed to require that exporters demonstrate the use of fishing methods which limit the incidental catch of endangered sea turtles when harvesting shrimp. The fact that sea turtles are protected by an international agreement helped establish that the U.S. requirement serves a veritable public interest and is not a disguised obstacle to trade. The fact that U.S. fishermen are obliged to use the safe measures for catching shrimp and that the ensuing higher costs limit their competitiveness would in itself not have made the U.S. provision admissible under GATT.

It is evident that the reduction of tariff protection will bring to the fore a lot of provisions allegedly or effectively carrying along some extra costs to domestic producers. All of them will be said to protect a public interest (often due to the simple fact that the presence of a public interest is in advanced countries a prerequisite for government to be entitled to legislate), justifying the political claim that exporters to the country should be constrained to conform with these national provisions to the letter. Against this background, the presence of international standards justifying the legislation and the requirement that the articulation of such legislation does not constitute a disguised obstacle to trade will usually be the determining factors when it comes to assess the conformity of safety provisions of all kind with GATT. The issue will reappear in Chapter 10 devoted to trade and environmental protection, but the list of public interests is longer, englobing the protection of human, animal or plant life or health; of public morals; of core labour standards; of national treasures of artistic, historic or archaeological value; also tax enforcement, protection of intellectual property rights and the prevention of deceptive practices enter into consideration.

These indications show that the WTO rules are not deaf to environmental, health, social and cultural concerns. At the same time, one needs to be aware that regulations are often "bought" (promoted) by industries. At least they are shaped by the interested, and often in a protectionist manner. This brings e.g. consumer protection organisations in a delicate situation. Traceability, i.e. to know from where a product origins and whether treatment on the way from the producer to the consumer has respected health and environmental standards ranks high among the requests of concerned consumers. Yet, these requirements will also help producers and traders to operate price discrimination among countries, since it acts against price arbitrage by parallel imports. Some caution regarding an increased recourse to processing and production measures (PPM) is therefore indicated.

At this point we leave for the time the negotiations on agricultural market access in the Doha Development round. Also, as indicated, the topic of processing and production measures will be further examined in Chapter 10 on environmental protection. As stated at the beginning and in connection with tariff escalation, an important question in this chapter is whether developing countries can locate within their boundaries a next step in the processing of the agricultural commodities grown on their soil. To support this goal, different instruments are used. One is to create a state trading company which will control the marketing of the products and eventually also operate plants for a first transformation of these (ginning in the case of cotton, for example, see Chapter 1). Another approach is to create special processing zones, i.e. areas within the country where processing firms are offered attractive framework conditions so that they transform the raw materials (beans etc.) there and not in the destination countries.

3 State Trading and Special Processing Zones

State Trading[71]

State trading enterprises (STEs) are defined as governmental and non-governmental enterprises, including marketing boards, which deal with goods for export and/or import. State trading is a common feature of many economies where agriculture is an important sector of trade. Thus, State trading enterprises are found in developed countries with significant agricultural trading interests, as well as in agriculturally-based developing countries. The heavy emphasis on agriculture in State trading activities would seem to indicate governments' belief that State trading is an appropriate means of implementing agriculture-related policy objectives, such as providing price support for important agricultural products or ensuring food security. In the area of industrial goods, State trading may arise as a by-product of the nationalisation of an ailing industry or as a means of pursuing government policies on products or industries considered to have strategic importance. One of the main problems relating to State trading in the context of a rules-based international trading system is the lack of transparency of the existence and activities of State trading enterprises. Even notification obligations regarding the presence of STEs were for a long time disregarded.[72] A significant area of potentially WTO-inconsistent practices may be escaping WTO scrutiny and regulation.

STEs may in particular be used as a vehicle for implementing a number of trade policy measures which are not consistent with WTO provisions. The most common is a violation of market access obligations. For example, an STE might be used to provide protection for the domestic market in a given product by setting resale prices of imports at very high levels, thus negating tariff concessions bound in WTO Schedules and violating Article II of GATT 1994. The provision of subsidies to STEs which are mainly involved in exporting may run afoul of export subsidy disciplines. Even in cases where the objective of the government acting through the STE is not intentionally trade-distorting, the STE's operations may nevertheless distort trade. For example, the protection of public health, which is a frequently stated rationale for the maintenance of monopolies on alcohol and alcoholic beverages, may seriously distort trade in those products. It is only when the activities of State trading enterprises can be examined that their impact on trade can be analysed and, ultimately, more effective rules developed.

Article XVII of the GATT 1994 is the principal provision dealing with State trading enterprises and their operations. It sets out that such enterprises – in their purchases or sales involving either imports or exports – are to act in accordance with the general principles of *non-discrimination*, and that *commercial considerations* only are to guide their decisions on imports and exports. The WTO does not seek to prohibit or even discourage the establishment or maintenance of State trading enterprises, but merely to ensure that they are not operated in a manner inconsistent with WTO principles and rules. This is further brought out by the *Interpretative Note* to Articles XI (General Elimination of Quantitative Restrictions), XII (Restrictions to Safeguard the Balance of Payments), XIII (Non-discriminatory Administration of Quantitative Restrictions), XIV (Exceptions to the Rule of Non-discrimination) and XVIII (Governmental Assistance to Economic Development) which states that throughout these Articles, the terms "import restrictions" or "export restrictions" include restrictions made effective through state trading operations. Work on this subject in the WTO is undertaken mainly by the Working Party on State Trading Enterprises. The relevant case law can be retrieved under the heading “State trading enterprises” in the WTO Analytical Index.[73]

Special Economic Zones

Many developing countries operate geographically delineated economic areas in the form of export processing zones, special industrial zones, or free trade zones. A paper produced by the World Bank[74] provides an overview of the application of World Trade Organisation disciplines to incentive programs typically employed by developing countries in connection with such special economic zones. The analysis finds that the disciplines under the Agreement on Subsidies and Countervailing Measures have the most immediate relevance for middle-income countries

[71] The text on STEs is taken from http://www.wto.org/english/tratop_e/statra_e/statra_e.htm and the attached WTO websites.

[72] TPRM Ghana 2014 admonishes that COCOBOD had not been notified.

[73] https://www.wto.org/english/res_e/booksp_e/analytic_index_e/index_s_e.htm

[74] See Creskoff, Stephen and Peter Walkenhorst (2009): Implications of WTO Disciplines for Special Economic Zones in Developing Countries, Policy Research Working Paper 4892, World Bank

that are members of the WTO.[75] One reason is that countries with a per-capita income below a threshold of US$1,000 are exempt from the provisions of this agreement. For the countries benefitting from certain "grandfathered" programs, the exemption expired by 2015.

The paper distinguishes promotional measures that are likely to conform with WTO rules, incentive schemes presumably inconsistent with WTO provisions and a third category of programmes where only a close scrutiny of their content will allow an assessment.

The following SEZ-related measures appear to be WTO legal:

- Exemption of exported products from import duties;
- Exemption of exported products from indirect taxes;
- Exemption of goods consumed in the production process from import duties and indirect taxes when the end products are exported;
- Exemption of production waste from import duties and indirect taxes when the waste is exported or discarded;
- Exemption of goods stored in SEZs from duties and indirect taxes; and
- Non-specific subsidies, including generally applicable tax rates imposed by national, regional and local government authorities.

Two classes of subsidies identified in Article 3 of the Agreement on Subsidies and Countervailing Measures elicit the greatest concern with regard to their consistency with WTO disciplines: export subsidies and import substitution or domestic content subsidies. In particular, WTO-prohibited government subsidies in connection with SEZ programs include (but are not limited to) the following:

- A direct subsidy contingent on export performance;
- Currency retention schemes involving a bonus on exports;
- Preferential transport and freight charges for export shipments;
- Provision of domestic products and services for exports at terms more favourable than those for domestic goods;
- Exemption, remission or deferral of direct taxes or social welfare charges if contingent on exports;
- Allowance of special direct tax deductions for exports above those granted on goods for domestic consumption;
- Exemption or remission of indirect taxes on exports in excess of those on goods sold for domestic consumption;
- Exemption, remission or deferral of prior stage cumulative taxes on goods or services used in the production of exported products in excess of products sold for domestic consumption (except for the exemption, remission or deferral of such taxes on "inputs consumed" in the production process);
- Provision of export credit guarantees or insurance programs at premium rates inadequate to cover long-term costs;
- Grants of export credits at rates below those which they pay for the funds, or at below market rates, or payment of all or part of the costs of obtaining credit; and
- Subsidies contingent on the use of domestic over imported goods.

Revolving to measures where WTO consistency depends on the facts of the particular case, there are several types of government policies that fall into this category, for example:

- Duty and tax free treatment of production equipment used in SEZs;
- Provision of materials and components in exchange for compensation that may not reflect full market value; and
- Government subsidies for infrastructure development in an SEZ.

It is important to note that WTO disciplines apply only to governmental measures. Today, a majority of SEZs are privately owned, developed and operated. Measures imposed by private SEZ operators are not subject to WTO disciplines, unless they implement a governmental measure. The paper concludes with a set of recommendations on how to achieve WTO compliance regarding government measures employed in connection with SEZ programmes. Possibly the single most important step toward eliminating questionable incentives is removing all requirements to export and permitting importation of goods man-

[75] For other WTO disciplines that may apply to SEZ programs in developing countries see the document we resume here.

ufactured in SEZs into the national customs territory without any restrictions other than the application of import duties and taxes.[76]

An important point is to see tariff escalation and special economic zones in their interaction, adding to the assessment also the reflections on e.g. tropical products and an eventual erosion of GSP and LDC preferences going along with such modifications in tariff schemes. It is the combined effect of all these steps that decides on the change in opportunity the Doha Development Round could bring to producers of primary commodities with respect to the integration of steps further down in value added chains (i.e. manufacturing) to their activities.

4 International Commodity Agreements

The volatility of prices for agricultural commodities is a destabilising factor for many countries in the developing world. This had already been recognised fifty years ago when a number of International Commodity Agreements was concluded. They knew a very limited success, however. The question of how to stabilise world market prices in the interest of continuous export earnings for weak economies remains unresolved, since.

In this section we look first at stock-building since this was at the core of many International Commodity Agreements. We will then indicate what today the function of these institutions created half a century ago is. In doing so, we draw on a paper prepared on behalf of the OECD.[77]

We will not address here the reasons of price volatility. In this regard, we refer to the Annex of the publication underlying the present text where we examine whether speculation on commodity exchanges might be an explanation. We also refer to Chapter 12 of the underlying publication where we examine the broader question of whether there is a natural resource curse, i.e. whether countries building on the extractive industries risk lower growth. The focus there is on mining and quarrying and one point is the volatile revenues they generate. The approach advocated there, namely to attenuate the adverse consequences of commodity price volatility by adopting fiscal rules, is also available for countries strong in exporting agricultural commodities. In part I of the Chapter 3 in the underlying publication, we had accordingly emphasised the unresolved problem in Ghana of fiscal stabilisation in the presence of commodity price volatility. Agricultural commodities have an additional component, however, since agriculture commodities create also a lot of domestic employment. This is not the case for mining and quarrying. With regard to employment, in chapters 1 and 2 of the underlying publication, we highlighted the difference it makes whether earning from commodity exports are a welcome diversification of farmers' revenue or whether it is the single income source in plantation farming. This impacts on the shock absorption capacity of either the producers or the public budget. Beyond budgetary measures, an element of a solution is also to use the agricultural safeguard clauses where WTO commitments are already binding and prevent a country from taking tariff measures when increased imports possibly at dumping prices discourage local production. It needs mentioning, however, that for governments in these countries to encourage agricultural production is not necessarily a priority. Cheap food for the destitute people in the suburbs of large towns on the coast may be as important, although it creates a dependency from world markets and governments do not always have the means to handle corresponding price and supply risks.

All these considerations make it clear why International Commodity Agreements could not constitute the single response to the intricate questions going along with commodity price volatility. The actual experience suggests even that their contribution to resolve these problems had always remained secondary, also because the schemes proved more difficult to handle than anticipated by their promoters.

The economic significance of stocks

With regard to stocks, the OECD report on which we draw here first notes that the low level of stocks up to the commodity price boom in 2008 was largely due to an apparent fall in Chinese stocks.[78] However, it is unclear whether the historical Chinese stock data can be regarded as reliable. Furthermore, it is doubtful to what extent these stocks, if real, would have been available had they been required outside China, or whether China, by reducing stockpiling in response to increasing world market prices, could have attenu-

[76] Consistent with the latter remark, under the ECOWAS Protocol, exports by EPZ enterprises to other ECOWAS countries are not eligible for preferential treatment, and are thus subject to customs duties.

[77] See Gilbert, C. (2011), "International Agreements for Commodity Price Stabilisation: An Assessment", *OECD Food, Agriculture and Fisheries Papers*, No. 53, http://dx.doi.org/10.1787/5kg0ps7ds0jl-en

[78] Excess demand or supply arising within China is huge when set into relation to the volumes of many commodities traded internationally!

ated price fluctuations. The pivotal role of Chinese demand (and supply) in many commodity markets would allow the country to act in such a way. The country could also counteract common efforts by the other nations (such as an ICA), however. In the case of cotton, China e.g. provoked a price spike in 2011/12 (see above Chapter 1, section 3).

With regard to the present context, the episode confirms the view expressed by the author of the OECD report, namely that the theoretically implied negative stock-price relationship is apparent in the data. Importantly, it observes also that the fit is poor and allows plenty of space for other factors to affect prices. This leads to the question whether the international community, in order to stabilise commodity prices, should constitute and manage stocks in public ownership. If "yes", the author would prefer to subsidise private storage rather than to replace it by public storage.

More importantly, he argues that deals on commodity markets may offer an alternative to storage in countering food price volatility. Specifically, the purchase of out-of-the-money call options allows an importing government to put an (approximate) ceiling on the price it will pay for its grain.[79] The cost of this protection is known and can be tailored to the specific situation of the country and the food markets in which it operates. And opposite transactions allow for stabilising export revenues over a limited horizon.[80] The development of future markets has indeed significantly changed the conditions under which Commodity Agreements would have to operate. The role these markets can assume may indeed be one deeper reason for the petering out of these agreements.

The fate of International Commodity Agreements

As said, substantial efforts had been made half a century ago to coordinate stockpiling among nations by setting up common agencies. There have been six series of International Commodity Agreements which have had "economic" (i.e. interventionist) clauses: the International Cocoa Agreements (ICCAs), the International Coffee Agreements (ICOAs), the International Natural Rubber Agreements (INRAs), the International Sugar Agreements (ISAs), the International Tin Agreements (ITAs) and the International Wheat Agreements (IWAs).[81] These ICAs negotiated in the 1960ies related to tropical export commodities, with the result that the exporters were developing countries and consumers were developed economies. This equation coloured future developments. Developed countries remained suspicious that the main intention of the producer country governments related to raising the level rather than reducing the variability of prices. The difficulty to gauge the extent to which the benefits from higher prices fed through to farmers, i.e. the question to whom the agreements benefitted, created additional scepticism.

The agreements differed with regard to the preferred instrument, either export controls or buffer

[79] Spatafora, Nicola and Issouf Samaké (2012): Commodity Price Shocks and Fiscal Outcomes, IMF Working Paper No. 12/112

[80] The action to be taken by the government of a country that relies heavily on revenue from exporting commodities is to acquire put options with an exercise price well below the market price. In principle, import and export dependent countries could strike a deal directly, exchanging call and put options in such a way as to limit the price fluctuation band relevant to both of them from both sides (i.e. the country dependent on food imports will eventually pay more than the market price if prices fall drastically). The question is whether such deals are not already an important part of the current commodities' markets, in the form of negotiated long term contracts. Depending on their importance, the problem of widely fluctuating commodity prices for communities may be exaggerated, but we lack observations on the attenuating effects on consumers, producers and government finances of prices and quantities exchanged based on long term contracts (or shielded by operations on the futures market). Interlinked with this question is the open point of the relative responsibility of the public and private sector. In this regard, however, it is worth noting that governments with exposed consumers or a GNP heavily dependent on mining and harvests have true problems in credibly committing not to react to adverse price movements leading out of a certain range of tolerance. It may well be the case that they have the price risk inevitably in their books due to emanating political pressures and should, faithful to the prudent man's rule, act accordingly. This opens the question of the knowledge and means of which these governments dispose (see also Chapter 1 regarding rules on public stock-building and negotiations of a special agricultural safeguard for less developed countries). Given that (partly contested) instruments are at disposal, commodity price volatility becomes a serious problem particularly when government's miss the ability to implement these.

[81] In addition, there is also a large number of "study group" style agreements. Their functions are information collection and dissemination, market promotion and, in certain cases, the fostering of research and development.

stock management by an agency, or some combination of the two. Export controls always create rents, partly because export quotas can be allocated to friends or political allies, and also because the administration of controls generates employment and therefore a vested interest in the continuation of controls. According to the author, the reason Brazil lost interest in coffee market control was the perception that the major beneficiary was the controlling IBC bureaucracy. The success of buffer stock arrangements hinges critically on the mechanism adopted for the revision of the price support range. If not adjusted timely to changing market fundamentals, stocks will either run out, making the instrument ineffective, or accumulate to a size that can no longer be financed. If, on the other hand, the stabilisation range adjusts so rapidly that it simply tracks the market price, the agreement will not stabilise prices to any useful extent.

For both instruments, accurate knowledge of the outlook for the current harvest (or on incidents limiting mining output) and of the long term evolution of market fundamentals is crucial. Given the intricate difficulties with handling the instruments, the focal point of ICAs has shifted from market intervention to becoming a platform where market participants establish a common knowledge base and eventually a shared opinion, supporting stabilising actions decided individually. The author therefore concludes that except in a single case (tin), intervention lapsed rather than collapsed. These changes in support took place in the context in which the markets for tropical export commodities were being liberalised and in which domestic stabilisation agencies – marketing boards and 'caisses de stabilisation' – were being dismantled or forced to accept reduced powers.[82]

The International Cocoa Agreements (ICCAs) in particular

The evolution of the International Cocoa Agreements (ICCA) is telling of the changing focus of ICAs. In their early times, the agreements relayed on quantitative production restrictions imposed on producer countries or a common buffer stock or both.[83] The first two Cocoa agreements of 1972 and 1975 contained both, export quotas plus stockholding obligations, but proved not successful or unnecessary (from the producer point of view!) since in the 1970ies, the ceiling price was below the market price.[84] This changed with the third agreement.[85] Negotiations started from 1979 on, but were marked by the absence of the Ivory Coast, a major producer with expanding production, and the US, the major importer with a government not supportive to commodity agreements. When the agreement came finally into effect in 1980, the financial means were in the 1981/82 season exhausted in 3 month due to an unrealistically high floor price. The forth agreement was then highly welcomed.[86] On the occasion of its adoption in July 1986, Kenneth Dadzie, then Secretary General of UNCTAD, described the International Cocoa Agreement as "the first of a new generation of International Commodity Agreements" (ICA). The justification for such a bold statement was that, for the first time in history, the objective of an ICA was exclusively geared towards the reduction of price fluctuations around the long-term market-determined trend. In the agreement the upper and lower intervention prices ("must sell" and "must buy" prices) were set at a distance of 40 U.S. cents from the reference price of 227 U.S. cents per kilo (SDR 1.935 at the time of adoption of the agreement). This meant a range of ± 17.6 percent from the reference price. The principal instrument foreseen in the 1986 cocoa agreement was a buffer stock of 250'000 metric tons. The buffer stock manager had some freedom with respect to selling and buying, through the introduction of a "may buy" and "may sell" price at ± 14.5 percent of the reference price. The most important new feature of the 1986 cocoa agreement was the flexibility of the price range due to two types of semiautomatic adjustments of the intervention prices. The first type related to an annual price review. In case the average indicator price over the preceding year had been outside the range, the intervention price would have increased (decreased) to such an extent that the indicator price

[82] See the descriptions of SOFITEX in Chapter 1 and of COCOBOD in Chapter 3 of the underlying publication.

[83] It may be shown that when supply is very inelastic buffer stocks tend to perform better than export constraints (see footnote below).

[84] Christophe Gouel (2014): Food Price Volatility and Domestic Stabilization Policies in Developing Countries, in 'The economics of food price volatility', a National Bureau of Economic Research Conference Report edited by Jean-Paul Chavas, David Hummels, and Brian D. Wright.

[85] The way to the third agreement is described in some detail in Renée Marlin Bennett (1993): Food Fights: International Regimes and the Politics of Agricultural Trade Disputes, New York: Gordon and Breach

[86] W. J. H. Van Groenendaal and J. W. A. Vingerhoets (1995): Can Intemational Commodity Agreements Work? Journal of Policy Modelling 17(3) : 257-278 (1995), Tilburg University, The Netherlands.

would come in a distance of 6 U.S. cents from the intervention price within the range. The maximum adjustment was set at 13 U.S. cents per kilo, unless the Cocoa Council decided otherwise by special vote. The second type of semi-automatic adjustment was triggered by a change in the size of the actually held buffer stock of 75,000 metric tons within a six-month period. In that case the adjustment of the intervention price foreseen was also 13 U.S. cents per kilo. A not unimportant novelty of the 1986 agreement was that all prices were expressed in SDRs instead of the U.S. dollar thus attenuating the perturbations of intervention prices originating in exchange rate variations. The authors on which we draw here performed then a number of simulation experiments over a period of 25 years. In their simulations, the highest price over the 25-year period decreases from 282 to 263 U.S. cents per kilo, and the lowest price increases from 161 to 171 U.S. cents per kilo. The stabilization of export earnings is even less significant. A measure for instability decreases by less than a quarter. These result are achieved with a limited number of interventions (all 3-5 years). The 1986 agreement was never fully utilized, however. The reason was a dispute over the use of one of its instruments (withholding) between producing and consuming countries in the spring of 1988.

The 1993 agreement fixed no longer specific intervention points. The provisions with regard to production state that "in order to deal with the problem of market imbalances in the medium and long term, and in particular the problem of structural overproduction, the exporting members undertake to abide by a production-management plan designed to achieve a lasting equilibrium between world production and consumption. The plan shall be drawn up by the producing countries in a Production Committee set up for this purpose by the Council. … In the light of the indicative figures fixed by the Committee, the exporting members shall as a group implement the production-management plan. … Each exporting member shall be responsible for the policies, methods and controls it applies to implement its production programme and shall inform the Committee regularly of any policies and programmes recently introduced or abandoned and of their results. ... The Production Committee shall follow and monitor the implementation of the production-management plan and programmes. … The Council may make recommendations to members on the basis of this assessment. … The financing of the production-management plan and programmes shall be borne by the exporting members. … Art.30 then foresees that to facilitate the evaluation of world cocoa stocks and to ensure greater transparency of the market, members shall provide the Executive Director, by not later than the end of May of each year, with information to which they have access on stocks of cocoa as at the end of the previous cocoa year held in their respective countries. On the basis of this information, the Executive Director shall submit to the Council for consideration at least once a year a detailed report on world cocoa stocks. The Council may thereafter make appropriate recommendations to members.

In the 2001 agreement, the stringency of provisions is further reduced. Art.34 says that "on the basis of these forecasts, and in order to deal with the problems of market imbalances in the medium and long term, the exporting Members ***may*** undertake to coordinate their national production policies. … The Committee shall submit detailed reports to each regular session of the Council, on the basis of which the Council shall review the general situation, in particular assessing the movement of global supply and demand in the light of the provisions of this article. The Council may make recommendations to Members on the basis of this assessment." Art.35 then requires that "in order to promote market transparency, the Organization shall maintain up-to-date information on Members' grindings, consumption, production, exports (including re-exports) and imports of cocoa and cocoa products and stocks." With respect to the latter, Art.36 stipulates that "in order to promote transparency in the market with regard to levels of world cocoa stocks, each Member shall assist the Executive Director in obtaining information on the volume of cocoa stocks in its country," to add: "The Executive Director shall seek the full cooperation of the private sector in this exercise, whilst fully respecting the issues of commercial confidentiality associated with this information."

Finally, the agreement of 2010 reorganised the suite of articles considerably. The paragraph saying that the exporting members may undertake to coordinate their national production policies figures at the end of an article entitled "Market Analyses". The essential change happens at the level of the comitology. On the one hand, an Economics Committee is established that shall be open to all Members. This is the operative body so that the Cocoa Organization can according to Art.30 "act as a global information centre for the efficient collection, collation, exchange and dissemination of statistical information and studies on all matters relating to cocoa and cocoa products." On the other hand, Art.44 establishes a Consultative Board on the World Cocoa Economy "to encourage the active participation of experts from the private sector in the work of the Organization and to promote a continuous dialogue among experts from the public and private sectors. The Board shall be an advisory body which advises the

Council on issues of general and strategic interest to the cocoa sector. The Board shall be composed of eight experts from exporting countries and eight experts from importing countries.” The provision in Art. 46 saying that the meetings of the Consultative Board on the World Cocoa Economy shall be open to all Members of the Organization as observers calms fears that the information exchanged there should interest competition authorities.

To sum up, the agreements from 1993 on allowed the possibility of market intervention through ever less specified production management measures, but no longer through a buffer stock. A core product of the International Cocoa Agreement of today are therefore the production figures as shown by the table below.

Production of cocoa beans
(thousand tonnes)

	2012/13	Estimates 2013/14	Forecasts 2014/15
Africa	**2836**	**3197**	**2984**
Cameroon	225	211	220
Côte d'Ivoire	1449	1746	1740
Ghana	835	897	696
Nigeria	238	248	235
Others	89	95	93
America	**622**	**708**	**729**
Brazil	185	228	215
Ecuador	192	220	250
Others	246	260	264
Asia & Oceania	**487**	**454**	**455**
Indonesia	410	375	370
Papua New Guinea	41	40	42
Others	36	38	43
World total	**3945**	**4359**	**4168**

Source: ICCO Quarterly Bulletin of Cocoa Statistics, Vol. XLI, No. 2, Cocoa year 2014/15

Published: 29-05-2015

Note: Totals may differ from sum of constituents due to rounding.

Chapter 3

Investment Protection Agreements

1 Main features of IPAs[87]

For a host country, FDI is an opportunity to bring foreign capital and knowledge into the country. But there is a considerable risk for the investor of being looted once he has made the investment. Most spending is irreversible and even when the investment can be sold (at a (presumably) depressed price) no guarantee exists that the money can be taken out of the country. This is to say that recipient countries have to solve the problem of credibly committing. A credible commitment guarantees enforcement of well-established property rights outside the country's boundaries in the case of undue appropriation or annihilation of the investment by future government acts. Such enforcement possibilities can not only be laid down in contracts the investor concludes directly with the host state, but also in treaties between the home state of the investor and the host state. For the home country, such treaties enhance the effectiveness of diplomatic protection. Since the focus of these agreements is not on market access but on investor protection, investment agreements are commonly also denominated as investment protection agreements.

A first Bilateral Investment Treaty (BIT) was concluded in 1959 and their number increased in the following years, driven by the fear of an expansion of soviet communism beyond its post-WWII boundaries and by decolonisation, the new governments often favouring centrally planned approaches to steering the economy. Starting in the 90', the number of BITs exploded, an evolution for which three reasons can be advanced: First, major global economic institutions such as the OECD and the UNCTAD began to push for them, considering FDI and its promotion an engine for growth. A second factor was conditioning the insurance for private investments into developing states on the presence of an investment treaty covering that investment. For instance, the International Finance Corporation (IFC), the private financing arm of the World Bank, sees BITs as an important risk management tool. A third factor behind the proliferation of investment treaties is the overall growth in FDI, making them more relevant.

Most investment treaties are bilateral, their number actually exceeds 3400 agreements,[88] but some investment treaties take the form of regional investment treaties. Examples are the treaties covering the countries in the Common Market for Eastern and Southern Africa (COMESA) and the Association of Southeast Asian Nations (ASEAN). Jurisdiction over the provisions contained in the North American Free Trade Agreement (NAFTA) has gained prominence. Furthermore, bilateral Free Trade Agreements of the 2nd generation regularly contain a chapter on investment. The latter do not directly compare to BITs, however. While BITs focus on providing protection to FDI that has already taken place in the host countries, investment chapters in FTA focus on opening up and guaranteeing FDI opportunities in the participating countries. Both forms of treaties may contain both elements, however.

The idea of multi-lateralising this network of bilateral treaties is straightforward, but never succeeded. Interested governments launched in May 1995 within the OECD negotiations on a proposed Multilateral Investment Agreement (MIA) with the idea that the other countries would later join the agreement, but the negotiations broke down in 1997 under the pressure of NGOs. In 1996, WTO member-countries decided at the Singapore Ministerial Conference to set up three new working groups, including one on investment, but the idea remained contested, also by developing countries, so that during the 2003 ministerial conference in Cancún, Mexico, the issue was dropped from the Doha agenda.

The "model" BITs used by many countries today are markedly different from those they used 20 years ago, but usually the following eight categories of provisions are present:

- Fair and equitable treatment (FET);

[87] The text of sections 3.1 and 3.2 is an excerpt from: Bernasconi-Osterwalder, Nathalie and Aaron Cosbey and Lise Kohnson and Damon Vis-Dunbar (2012): Investment Treaties & Why they Matter for Sustainable Development, published by the International Institute for Sustainable Development, Winnipeg, with the support of the Swiss Agency for Development and Cooperation (SDC).

[88] http://unctad.org/en/pages/DIAE/International%20Investment%20Agreements%20(IIA)/IIA-Tools.aspx

- Compensation in the case of direct or indirect expropriation;
- National treatment, or treatment no less favourable than that given to domestic investors;
- Most-favoured nation (MFN) treatment, or treatment no less favourable than that given to investors from third countries;
- Freedom from so-called "performance requirements" as a condition of entry or operation. These are requirements, for example, to transfer technology, to export a certain percentage of production, to purchase inputs domestically, or to undertake research and development locally;
- Free transfer of capital;
- A blanket obligation, known as an "umbrella clause," which obliges the host state to respect any legal or contractual obligations it may have to the investor;
- The right to bring arbitration claims against host governments.

The paragraphs that follow will examine the first seven provisions in more details. The eighth and final point needs further subdivision and will be the topic of section 3.2.

The fair and equitable treatment clause: The FET-clause has in numerous cases allowed investors to succeed where their expropriation, non-discrimination and other claims have failed. It has thus become a kind of "catch-all" clause. Host states have, for example, been found to violate it for a failure to act in a transparent manner in administrative decision making. Other violations have been found in the inconsistent actions of host state agencies vis–à–vis the investor, such as the encouragement and approval of the investment by one agency and the denial of the necessary zoning permits by another. One solution to the vagueness what FET comprises would be to require only that the host government does not behave in a manner that is egregious and shocking, another solution might be that investors' expectations must be reasonable and legitimate *in light of the circumstances prevailing in the host country.* Clearly, host governments should always be transparent and act consistently, but the reality is that they are not always proceeding so, particularly when more than one agency or level of government is involved. Coordination among ministries and different levels of government is difficult even for developed countries, making a standard of freedom from ambiguity and total transparency seem unrealistic for any country. A favourable result of a FET-provision may be that states will proactively improve their regulation and administration with respect to investors. But in a dynamically evolving environment, regulatory change becomes through such provisions and the use made of them in arbitration a gamble. The author of the handbook from which these indications are taken suggests an interpretative note, indicating that the FET requirement is synonymous with the customary international law minimum standard of treatment of aliens. Basic requirements are that expropriation is for a public purpose; non-discriminatory (that is, not targeted at a specific company or nationality); and in accordance with the due process of law. Explicit guarantees by the host government that it will not take the measures in question deserve also protection, an aspect relevant in cases of indirect expropriation.

The inclusion of indirect expropriation: Expropriation is generally described as falling into two categories: direct and indirect. Can measures taken for a clear public purpose, such as public health or environmental protection, constitute an indirect expropriation? The cases decided to date do not provide a clear answer. The outcome depends on the facts of the case, as well as the test applied by the particular tribunal evaluating it. There are three competing principles:

- the "sole effects doctrine": If legal change causes a write-down on the investment, an indemnity is due, irrespective of the nature of the legal change,
- proportionality: Legal changes may cause a certain depreciation of the investment, but the loss incurred has to be justified by a substantive improvement of the public good the legislation pursues,
- the "police powers" carve-out: The host state is free to legislate in the area of basic security provisions ("police goods"), such as the protection of life, health and the environment. Such legislation can not constitute an indirect expropriation and is carved out from the application of the treaty.

A problem with indirect expropriation is that arbitrators are not obliged to follow any one, or indeed any, precedent, often delivering awards that seem to be at odds with previous decisions. The legal uncertainty reigning today is problematic for both the host state and the investor. As a response, an increasing number of states are incorporating additional language in their investment treaties clarifying the scope of indirect expropriation. However, depending on the specific circumstances, an arbitration panel may not be wrong when it concludes that the reasoning behind an act amounting economically to indirect expropriation was not adopted due to e.g. environmental concerns, but rather that the government measures were taken to appease local protestors.

Treatment no less favourable than that given to domestic investors: The more finely a tribunal identifies differences and draws distinctions between domestic and foreign investors, the less likely it will be that it will find a domestic investor has been treated differently than the foreign investor. It makes e.g. a distinction whether adherence to a certain industry or the utilisation of a certain technology serves as the distinguishing criterion. National treatment rights at the pre-establishment stage entail particularly significant commitments, and are seldom offered across the board. Rather, as with the GATS and some investment chapters in FTAs, states that offer these rights will often do so only in certain identified sectors (the *list-in* or positive list approach), or they will specify a list of sectors, activities, and/or policy areas in which the commitments do *not* apply (the *opt-out* or negative list approach).

The MFN clause: There is an ongoing debate on whether and to what extent it should be possible to use the MFN clause in BITs to import favourable provisions from other treaties signed by the host state. Could an investor, e.g., import obligations from agreements other than BITs? Could it complain that a host country had caused it harm by actions that violated commitments under the WTO's GATS, TRIMs or TRIPs agreements? The drafters of those agreements never intended to grant private investors the right to enforce those treaties' provisions through binding arbitration initiated by private parties. And how about the WTO agreement on Government Procurement, which is clearly not an investment agreement?

Performance requirements: Apart from reference to the TRIM agreement, the majority of investment treaties do not mention performance requirements. However, the United States and Canadian agreements do so since the NAFTA contains them, as do agreements concluded by some Asian countries. The European Commission might negotiate rules to limit the use of performance requirements in its future investment treaties or chapters. Note that the TRIMs agreement does not permit investors to bring themselves measures like performance requirements to arbitration. Economic theory cannot show that performance requirements are a bad policy for the host country. Spending on research and development (closely correlated with the capacity of innovation) is typically higher in head office states than in subsidiaries. Arguably, the greatest downside of the infant industry approach is the risk that the infants will never "grow up" and the economy will be indefinitely saddled with inefficient low-quality producers.

Free transfer of capital: Multinational enterprises function to some extent also as banks. They have to finance the own capital needed for new FDI by cash flows taken out of existing investments, and they actively manage exposure to exchange rate risks and the like. The withdrawal of funds should however not occur in contradiction of the 'ordre public' of the host state. The host state usually reserves the right to enforce laws relating to (1) bankruptcy and the protection of creditors' rights, (2) issuing, trading, or dealing in securities, (3) enforcement or collection of fines and judgments, and (4) financial reporting. Some also contain safeguard or other provisions allowing states to take measures to prevent or respond to balance of payments or other general macroeconomic crisis, provisions that are more difficult to accept from the point of view of an honest investor. However, EU member states have been called by the European Court of Justice to review and re-negotiate the sweeping free transfer clauses contained in their BITs. According to the court, this is necessary in order to bring the agreements into compliance with European law, which demands more flexibilities in times of financial and macroeconomic crises.

The umbrella clause: The umbrella clause in the US-Argentina BIT of 1994 reads: "Each Party shall observe any obligation it may have entered into with regard to investments." Such a clause could make enforceable any provisions the host state has entered to with respect to investment, e.g. GATS obligations. Not all courts finished by giving to such an encompassing clause a narrower meaning, for example, that it makes the actual contracts between host states and foreign investors enforceable. With this limited scope, the umbrella clause may become particularly potent when combined with an investor–state contract that features a stabilization clause. Stabilization clauses are clauses that promise to insulate the investor from changes in the host state's laws, and they typically figure in capital-intensive, site-specific, long-lived investments such as projects in the extractive industries. On expropriation, for example, stabilization clauses may completely moot the police powers carve-out described above. It has to be noted that stabilization clauses may alter the nature of the commitment to FET as well. An important component of FET in many of the arbitration rulings is the requirement that the host state respects the "legitimate expectations" of the investor when it decided to invest. While umbrella clauses are frequent in BIT, the fact is that almost exclusively developing countries sign contracts with investors including stabilization clauses.

The notion of investment: Contracting parties may finally have an interest to clarify what may potentially qualify as an investment. For example, states have excluded from the scope of covered "investments" such items as debt securities issued by a government; portfolio investments; or claims to money that arise solely from commercial contracts for the sale of goods or services. Special provisions may also ensure that investments made through bribery, fraud or corruption, or investments not approved by the host country do not benefit from the treaty. Some states have also shifted towards an enterprise-based definition. As it can be simple for a foreign entity to create a formal presence in the home state for the purpose of seeking the protection of an investment treaty, some treaties also require that companies have sufficiently substantial business activities in the home state.

Typically, an investment treaty provides that it will stay in force for a given period of time, often 10 or 15 years. Usually, it will continue to stay in force until either party gives written notice of termination. However, for existing investments, the provisions of the agreement will continue in effect for another given period after denial.

2 The Investor-State Dispute Settlement Mechanism

Entitlement to initiate an arbitration procedure: Bilateral Investment Treaties allow for a State to State dispute settlement, but additionally also often for an arbitration between the investor and the host state. Over the last two decades, investors have increasingly used the investor–state arbitration process included in most investment treaties, a process unique in international law that allows private investors to take host state governments directly to international arbitration, without the support or even knowledge of their home state. Also, investors are allowed to proceed directly to international arbitration, without exhausting possibilities to bring the case to national courts, unless the treaty provides otherwise. Investors have challenged a broad range of government measures as allegedly violating the investment treaties and harming the investors' rights. For sure, they also use the threat of such arbitrations without necessarily disclosing it.

Institutions and rules supporting the arbitration procedure: Most treaties provide a choice between the rules developed under the auspices of the World Bank's International Centre for Settlement of Investment Disputes (ICSID), or those developed by the United Nations Commission on International Trade Law (UNCITRAL), the UN body responsible for international business law. Sometimes additional options are offered, such as the arbitration rules of the arbitration facilities of the Stockholm Chamber of Commerce (SCC) or the International Chamber of Commerce (ICC). ICSID was established in 1965 under the convention on the settlement of investment disputes between states and Nationals of other states (the ICSID convention) which has been signed by over 140 states. ICSID's caseload has expanded significantly in the last decade; 166 claims were registered with ICSID during 1995–2005, compared with 30 cases in the 30 years prior. Today ICSID is by far the most commonly used arbitration facility for investor-state arbitrations. It is also the most visible, in part because of its popularity but also because it maintains a publicly accessible list of pending cases.

Forum shopping: Investors have been allowed to claim breaches of a contract in local courts, and breaches of an investment treaty in international arbitration, even when the same fundamental complaints lie at the heart of both claims. "Fork-in-the-road" provisions allow investors to weigh their options and choose whether to pursue their claims in domestic courts or through investor–state arbitration, but require that once an investor has elected one route, the other is closed off.

Appointment of the arbitrators: It is common for lawyers to move between the roles of arbitrator and counsel. One solution to the emerging problem with the impartiality of the judge (an arbitrator will, willingly or unwillingly, consider what positions he defends in his parallel activity as counsel) is a roster of permanent arbitrators, under tenure for a given number of years, which would also help insulate arbitrators from economic and political pressures.

Awards: The claims for relief can be broken down into five general categories: (1) monetary compensation; (2) restitution or return of property; (3) punitive damages (i.e., an assessment of damages against the state designed not to compensate the investor for harms suffered, but to punish the state for wrongful conduct); (4) declaratory relief (i.e., a declaration deciding a particular issue in dispute); and (5) injunctive relief (i.e., an order telling the government to take, or refrain from taking certain action). With the exception of punitive damages, which are generally said not to be allowed in investor–state arbitrations, or only allowed in "exceptional circumstances," investors have been successful in securing all other forms of relief. Requiring and awarding injunctive relief is particularly problematic as in this case the alleged limitation of the legislator in its decisions becomes a reality.

Enforcement: Two international treaties give arbitral awards this force. The first is the 1958 convention on the recognition and enforcement of foreign arbitral awards (the "New York Convention"); the second is the 1965 ICSID convention. The New York Convention requires its roughly 150 state parties to recognize and enforce foreign arbitral awards. It provides that states may only refuse to do so on seven limited grounds. UNCITRAL allows for the establishment of an "annulment committee," but these committees can only annul an award on five grounds. A centralized mechanism for appeal, such as exists for international trade law disputes under the auspices of the WTO, would be welcome.

Transparency: Access of the public is limited. If one of the disputing parties wishes, e.g., the hearings must be closed. The only guaranteed disclosure will come from the ICSID secretariat, which, pursuant to a 2006 revision of the ICSID arbitration rules, is required to publish excerpts of the tribunal's legal reasoning behind the award. Under the 1976 and 2010 UNCITRAL arbitration rules, disclosure is even more limited since both parties have to agree (this point was under revision in 2011).

Third parties: Submissions by third parties acting as 'Amici curiae' can play an important role in investment treaty arbitration. They can provide expertise on points of law, offer historical and cultural context to a dispute, and reveal how a particular dispute has wider ramifications beyond the interests of the disputing parties. Investment treaties and arbitration rules give the tribunals the authority to permit *amicus curiae* submissions.

Balance of rights and obligations: Overall however, tribunals do not appear to be considering investors' compliance with domestic environmental, labour, or tax law after the investment is established. Several observers would have the treaties go further and suggest imposing binding obligations on investors under the agreements, including obligations on corruption, environmental impact assessments and management, and labour and human rights issues.

Expropriation of HOLCIM in Venezuela[89]

Holcim, a Swiss-based world leader in cement

Founded in 1912 to become rapidly a leader on the Swiss market, Holcim created subsidiaries in France and then throughout Europe and the Middle East already during the 20'. After expansion in the Americas during the 50', the company added Latin America and Asian divisions during the 70' and 80' to its business, often through mergers and acquisitions. Holcim went public in 1958. As of 2014, the company was present in more than 70 different countries and employed 71'000 people. On 7 April 2014, the world's two largest cement manufacturers, Holcim and Paris-based Lafarge, announced they had agreed after three month of negotiations to terms on a "merger of equals", effective in the first half of 2015. LafargeHolcim combined sales will amount to € 32bio.

Venezuela under President Hugo Chávez[90]

Venezuela, colonized in 1522, became in 1811 one of the first Spanish-American colonies to declare independence. During the 19th century, Venezuela suffered political turmoil and autocracy, remaining dominated by regional caudillos until the mid-20th century. Since 1958, the country has had a series of democratic governments but economic shocks in the 80' and 90' led to several political crises. A collapse in confidence in the existing parties saw the 1998 election of former career officer Hugo Chávez and the launch of the Bolivarian Revolution, beginning with a 1999 Constituent Assembly to write a new Constitution of Venezuela. Chávez implemented participatory democratic councils, the nationalization of several key industries, and increased government funding of health care and education. Significant reductions in poverty were made with spending the increasing oil revenues. Winning his fourth term as president in the October 2012 presidential election, Chávez died in Caracas on 5 March 2013 at the age of 58. The second presidential election after Chávez's death saw his successor Nicolás Maduro with contested 50.61% of the votes as the winner. Since Chávez' death, demonstrations and riots have left dozends of fatalities in the unrest between his followers and opposition protesters. Whether the elections of 2015, won by the opposition, will bring an improvement is uncertain since the government in place is reluactant in accepting the vote.

The dispute

On 8 April 2008, Holcim Ltd released a statement, saying that Holcim Venezuela had been officially informed by the Venezuelan government of its plans to nationalize all foreign cement producers operating in the country. Holcim had been active in Venezuela since 1978, successively increasing its stake in the country. By 2007, Holcim Venezuela operated two cement plants. At the request of the Venezuelan government, they had exclusively been producing for the domestic market for a considerable time. Holcim Venezuela with its 774-strong workforce recorded net sales of approximately US-$ 200mio, accounting for approximately 1 percent of Group turnover, and had regularly been investing in efficiency improvements and environmental measures. On 18 August 2008, a basic agreement was signed,

[89] Source: Press releases by Holcim Ltd. (http://www.holcim.com/media-relations.html)

[90] Source: Entries on Wikipedia, keywords Venezuela and Hugo Chávez, as of August 11th 2014.

stipulating that the State of Venezuela will purchase 85 percent of Holcim Venezuela and the Holcim Group will keep a stake of 15 percent. The two parties also reached an agreement in principle on the compensation, subject to a financial due diligence. In the media release for the business year 2008 of 4 March 2009, Holcim then reported, under the heading of post-balance sheet events, that the state had taken control of Holcim Venezuela. It added that the payment of the compensation of US-$ 550mio as agreed in a Memorandum of Understanding with Petróleos de Venezuela S.A. (PDVSA), acting on behalf of the Venezuelan Government, was still due. Holcim stated its determination to safeguard the interests of Holcim and its local employees in accordance with the bilateral investment protection agreements in place between Switzerland and Venezuela, dated 18 November 1993, and declared that the company would appeal to the International Center for Settlement of Investment Disputes in Washington. Demanding full compensation, Holcim said on 31 July 2009, that it had to date not received a compensation offer from the Republic of Venezuela that is acceptable from a legal or financial standpoint, and that it will continue with the arbitration proceedings as filed with the ICSID. On 13 September 2010, Holcim signed a settlement with the Bolivarian Republic of Venezuela agreeing on a compensation payment of US-$ 650mio and the suspension of the international arbitration procedure pending before ICSID. A first down-payment of US-$ 260mio having been rendered, the remaining compensation amount of US-$ 390mio should be paid in four equal yearly installments.

3 A critical assessment

As set out in Chapter 6 in the underlying publication, there are multiple motives to engage in FDI. The presence or absence of a BIT is not a ‘sine qua non’ for FDI flows to occur, rather their impact must be studied within the context of the political, economic and institutional features of the host country that is signing the BIT and in light of the worldwide BITs regime. While part of the available empirical studies conclude that those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return (e.g. Neumayer and Spess (2005))[91], other studies came up with counter-intuitive results or raised questions regarding whether investment treaties actually cause an increase in investment flow or whether other concomitant factors, such as broader changes in economic policy, are responsible for the result. In a study of 2011, Mudziviri Nziramasanga, Frederick S. Inaba and Sanatan Shreay from the Washington State University[92] extend the analyses in interesting directions. Based on a panel including 143 developing countries and the data period 1961-2006, the authors observe first that after an initial positive impact of concluding a BIT, FDI tended to stagnate or even receded. Theoretically, they explain this pattern as follows: While giving the investor the right to have disputes with the host country arbitrated by international panels is key to the credibility of the host country’s commitment to the BIT, the BIT-constrained host country, nevertheless, retains wide policy flexibility as a sovereign nation, and still may choose to abrogate specific obligations made to foreign investors when the country’s interests dictate so. The dispute itself then lowers the perceived credibility of the host country’s commitment and thereby mitigates some of the BIT’s influence to attract FDI. They see their empirical analysis of the determinants of FDI flows to developing countries in accordance with the mechanism described. Specifically, they find that BITs are significant in attracting FDI flows and that disputes tend to have a significant negative effect on FDI flows. Investment is primarily discouraged through periods of economic contraction relative to the source country, periods of relative expansion not exercising a comparable positive impact. Finally, a relatively large volume of intermediate goods imports indicates some restraint by the host country from discriminating against foreign economic activities (by imposing e.g. domestic content provisions), and thereby enhances the prospects for foreign investments. They conclude that while BITs serve as temporary, if imperfect, substitutes for institutional protections, they do not obviate the need for credible reforms to establish domestic institutions that create a predictable economic environment.

While one may therefore conclude that BITs fulfil their purpose, one has also to accept that the current agreements and relevant institutions lack some of the basic characteristics one would expect from a good regime of governance, includ-

[91] Neumayer, Eric and Laura Spess (2005): Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries? World Development, 33: 1567-1585.

[92] Nziramasanga, Mudziviri and Frederick S. Inaba and Sanatan Shreay (2011): Do bilateral investment treaties deliver the goods? Evidence from developing countries, Review of Applied Economics, vol. 7, no. 1-2.

ing predictability of results, certainty about commitments, balance between treatment of investment and other public goods, presence of impartiality, transparency and openness. The most important message of the handbook we resume here is that there are viable options for addressing at least some of the problems raised by the current system: "None of them is overly complex, none is pioneering in the sense that they have not been used successfully in other contexts, but all require a good measure of political will."

In particular, critical observers make the point that by the ISDSM, a small group of arbitrators reviews decisions democratically taken by a vast majority. There is however nothing extraordinary in this fact. International treaties often allow for arbitration, and within national borders, constitutional courts exist in many countries and are given the power to review at least the decisions of regional entities. Even where new legislation may not be reviewed by such courts, economic agents are often given a chance to seek redress for an undue and disproportionate loss. This may even be the case when the latter is not due to decisions specifically addressed to the agent in question, but due to a new law (a law being by definition addressed to an unspecified number of judicial and natural persons). This is to say that in order to obtain compensation, expropriation does not need to be formal; to deprive an owner of the substantive benefits of his property is regularly assimilated to a formal expropriation. When the criteria for substantive expropriation are fulfilled will usually be decided on a case by case basis. Provided the redress is in form of a cash amount, it is wrong to argue that the legislator is restrained in his ability to decide on new legislation by the ISDSM, but eventually legal change comes at extra costs to him; there may be a chilling effect. However, whether these costs are indeed disproportionate, if not prohibitive has to be assessed against the benefits obtained by the country thanks to having been able to credibly commit not to expropriate investors without due compensation. Finally, it goes without saying that prior governments may restrict later political decisions by signing international treaties. Abrogation clauses are standard in such treaties and allow for future political developments. Venezuela, e.g., has put a term to its BITs (but pays currently also one of the highest risks spreads on government bonds, although the latter is a reflection of the dismal general investment climate of which the abrogation of BITs is only an expression).

On the other hand, not any legal change that has unfavourable financial consequences for an economic agent can and should be assimilated to substantive expropriation. A number of decisions taken by arbitration based on the ISDSM comes, however, close to compensate for legal change as such.[93] Expressed differently, companies may have received money for amendments in legislations they would have had to accept without any chance of redress in their home country, even if the latter is a privileged place for foreign investment. According to a ruling[94] by the Federal Court in Switzerland, e.g., substantive expropriation is present when the owner can no longer use his property in the actual way or in a way that can be anticipated, provided the restriction weighs heavily due to the fact that a right that is constitutive of property is withdrawn. E.g., if a lot is in an area where according to zoning in vigour construction is possible, to withdraw the right to construct is tantamount to a restriction having this quality. Still, compensation is only due in Swiss law when an anticipated usage of the substantive right (namely to construct) would have been exercised with high likelihood in a near future. The Federal Court assimilates the withdrawal of minor rights to substantive expropriation when the loss incurred by a single agent is disproportionate and obliges the owner to a sacrifice in the interest of the community that weighs so heavily that without compensation an infringement of the principle

[93] The EU Commission (source see below) points e.g. to the ruling in the litigation about tobacco advertising legislation between Philipp Morris and Australia.

[94] BGE 131 II 728 ff., 730 ff. E.2: „Eine materielle Enteignung... liegt vor, wenn dem Eigentümer der bisherige oder ein voraussehbarer künftiger Gebrauch einer Sache untersagt oder in einer Weise eingeschränkt wird, die besonders schwer wiegt, weil der betroffenen Person eine wesentliche aus dem Eigentum fliessende Befugnis entzogen wird. Geht der Eingriff weniger weit, so wird gleichwohl eine materielle Enteignung angenommen, falls einzelne Personen so betroffen werden, dass ihr Opfer gegenüber der Allgemeinheit unzumutbar erscheint und es mit der Rechtsgleichheit nicht vereinbar wäre, wenn hierfür keine Entschädigung geleistet würde. In beiden Fällen ist die Möglichkeit einer künftigen besseren Nutzung der Sache indessen nur zu berücksichtigen, wenn im massgebenden Zeitpunkt anzunehmen war, sie lasse sich mit hoher Wahrscheinlichkeit in naher Zukunft verwirklichen. Unter besserer Nutzung eines Grundstücks ist in der Regel die Möglichkeit seiner Überbauung zu verstehen."

of equal treatment before the law would result. One may legitimately ask the question whether compensation paid according to such a standard would give foreign investors sufficient incentives to move into all countries.

The fact that decisions taken within the ISDSMs go beyond the notion of substantive expropriation in Swiss law may be due to formal aspects of the ISDSM mechanisms. Such litigation is good business for law firms and the small community of arbitrators gains considerable personal prestige by sitting in a panel, these aspects creating an incentive to balance the number of cases lost and won in order not to run out of business.[95] Furthermore, there is no appeals procedure; while this may save costs and time – the very advantage of arbitration procedures that, for this reason, have little standard setting capacity – the same fact leads to a lack of consistency between individual decisions. Additionally, the decisions are not made public unless the parties involved agree to do so. This further inhibits control and cohesion, limits public discussion on the evolution of the standards the arbitration bodies shall adopt and conveys a competitive advantage to certain law firms who know the outcome of cases that were settled without disclosure of the final ruling.

As we will see in the next section, negotiations among two major trading blocks may in due time set new standards by which these deficiencies will be overcome.

4 The ISDSM in the proposed TTIP

In June 2013, the European Council asked the European Commission to start negotiating a free trade agreement with the United States, called the Transatlantic Trade and Investment Partnership (TTIP). In the guidelines for these negotiations, the member states agreed that the EU should seek to include provisions on investment protection and investor-to-state dispute settlement (ISDS) in the proposed agreement, reasoning with existing treaties between EU member states and the US and a general policy of the EU to include such provisions in its trade agreements. Given the strong public interest in this issue, the European Commission started in March 2014 consulting the public in the EU on a possible approach to investment protection and ISDS and outlined a series of innovative elements in an explanatory notice.[96]

As a basic principle, the Parties' right to regulate and to pursue legitimate public policy objectives shall be explicitly reaffirmed. When the state acts in a non-discriminatory way to protect the public interest, guarantees shall be provided so that the measures it takes cannot be considered equivalent to an expropriation. Neither a loss of profits by the investor nor compulsory licenses issued in accordance with WTO provisions guaranteeing access to medicines shall be considered an expropriation. The obligation to provide 'fair and equitable treatment' will be defined within precise limits by a list of acts that could constitute a breach: manifest arbitrariness, denial of justice, abusive treatment such as coercion, duress or harassment. As in other EU free trade agreements, in the TTIP the Parties would be able to adopt and enforce prudential measures – preventive measures taken by a state to ensure the stability of its financial system. Shell companies shall not be protected, only substantive business operations in the territory of one of the Parties could qualify a company as an "investor". Abuse of the system shall be prevented by allowing for the early dismissal of unfounded claims and by preventing investors from bringing multiple claims in various jurisdictions. Also, the losing party will bear the cost. Increased transparency shall be achieved by including the new UNCITRAL rules in the TTIP, with the effect that all ISDS documents will be publicly available, hearings will be open to the public and interested third parties – such as NGOs – will be able to intervene during the proceedings. Conflicts of interest or bias in arbitrators shall be prevented by a code of conduct with specific and binding obligations for arbitrators, including on conflicts of interests and ethics together with rules on how these should be enforced. Better consistency and control shall be ensured through an appellate body to review awards. Control of the agreement shall be kept by allowing the Parties to the agreement to agree on how they interpret a certain provision. This interpretation will be binding on the arbitral tribunal and direct the interpretation by arbitrators. The Parties can also intervene in ISDS proceedings to present their views on how the agreement should be applied. A further element

[95] The risk of ‚pantouflage' needs also to be considered. The fact that arbitrators do not change too frequently limits the risks that an arbitrator is paid for a ruling favourable to a company by future business or employment opportunities offered to him; this risk appears as asymmetric, that arbitrators speculate on a 'payment' by later mandates granted by public authorities appears to the author as less likely; still, appointment as professor a.s.o. is not excluded as a benefit, making the need for cooling down periods pressing.

[96] http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152279.pdf

shall be that ISDS will only apply to breaches of the investment protection provisions and not to other parts of the TTIP agreement. In particular, ISDS shall not apply to market access or regulatory provisions.

The Commission estimates that these provisions will correct the apparent weaknesses in investment agreements. The EU will have difficulties in conceding less than these provisions in treaties with other states. A tendency to abrogate these treaties could therefore be stopped.

Chapter 4
The Trade Regime for Textiles

1 MFN tariff rates remain high for textiles and clothing
2 Frequent protectionist measures in contradiction with basic GATT principles
3 Tariff concessions granted through preferential trade agreements matter
4 The articulation of Rules of Origin (RoO)

The Textiles and Clothing (T&C) sector stands out due to the high tariffs which still apply, but also due to the importance of trade distorting government measures. Furthermore, an increasing importance of regional proximity is shaping the trade pattern. These features explain the organisation of this chapter:

- We will first present figures showing that tariffs in the sector of textiles and clothing are high when compared with the ones applied to the products of other industries. Tariffs were indeed used to withstand the pressure for factor price equalisation.
- We will then point to the rich arsenal of protectionist measures that the established producers of clothes and textiles have additionally put in place. Many of these measures were in flagrant contradiction with the basic principles laid down in the GATT agreement.
- As a next step, we will show that the high preference margins granted through the conclusion of preferential trade agreements were affecting the decision where in the production of garments the single steps in the creation of value added are located.
- We will then argue that the granting of preferential tariffs to a selection of less developed countries was not an unquestionable benefit for these countries. The industrialised world repatriated part of the benefits by way of the specific articulation of rules of origin.

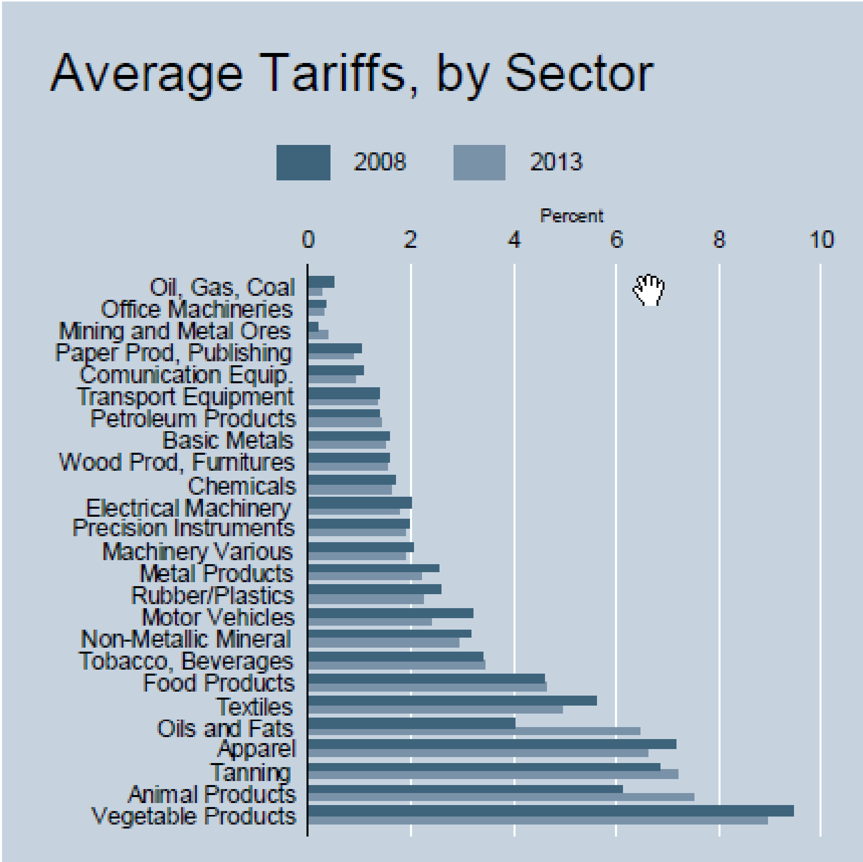
1 MFN tariff rates remain high for textiles and clothing

Tariff protection had been dismantled in seven negotiating rounds in the period of the GATT, culminating in the Uruguay round. With regard to non-agricultural market access, a general impression grew that non-tariff trade barriers started to weigh heavier than the duties that were still collected. Low utilisation rate of tariff concessions under FTAs were taken as a further indication that MFN rates had stopped to be a major obstacle to trade. However, besides agriculture, there is one manufacturing sector where such an impression is misleading, namely the textile and clothing sector.

As Adhikari (2007) in a study prepared for an UN Department observes,[97] the tariffs imposed on T&C products continued after the Marrakesh compromise to be on average four times higher than the average industrial tariffs imposed by the developed countries. More precisely, the average post-Uruguay Round tariffs on T&C products were 14.6 per cent in the United States, 9.1 per cent in the EU and 7.6 per cent in Japan, while their average industrial tariffs were 3.5, 3.6 and 1.7 per cent respectively. Furthermore, disaggregated data still reveal remarkably high tariffs imposed on some selected products (tariff peaks). Adhikari (2007) commented: “The high tariff on T&C products has become an even more important trade policy tool in the hands of the developed countries with the dismantling of some protectionist measures [i.e. the quota system; see next section] and is not likely to come down significantly even if the stalled negotiations on non-agricultural market access (NAMA) were revived at the WTO.”

It needs emphasising that the calculation of tariffs in the T&C sector is demanding. Due to the comparatively high rates, it matters how weighting is done when averaging the rates applicable to single tariff lines. Clearly, un-weighted averaging and averaging with observed quantities is inferior to weighting with what imports were at a uniform rate, but the latter imports cannot be observed and to use instead the import structure of an aggregate of countries as a weighing scheme is only second best in providing an idea of tariff protection. Furthermore, specific duties in addition to ad valorem tariffs are quite common in the T&C sector. The former discriminate against exporters of low cost textiles which are not necessarily inferior in quality since the low price may only reflect the absence of branding. In transforming specific duties in ad valorem equivalents, the price band dominating in the imports of a country matters. Given these complexities, we will rely here on data published by an international organisations. We benefit of a publication by UNCTAD on trade weighted average tariffs by economic sector:

[97] See: Adhikari, Ratnakar and Yumiko Yamamoto (2007): The textiles and clothing industry: Adjusting to a post quota world, in UN, Department for Economic and Social Affairs: Industrial development for 21th century, New York.



UNCTAD: Key Statistics and Trends in Trade Policy – 2014 (draft advance copy), table 4b), p.4. see http://unctad.org/en/PublicationsLibrary/ditctab2014d3_en.pdf.

The figures include tariff reductions granted through preferential trade agreements. This is the essential reason why average tariffs came down between 2007 and 2013 while the Doha-Round negotiations remained stalled.

While reflecting preferential rates, the figures in the table above still give not the full picture of protection. The tightness of rules of origin and the possibilities of 'cumulation' laid down in preferential trade schemes (for an explanation see below) are not reflected. The threat of anti-dumping allegations is also not represented. And, of course, the costs of coping with NTBs are not appearing in the table. With respect to the latter, Adhikari (2007) indicated in his report the number of documents and signatures it took to export or to import T&C products. The importance of red tape was at the time in OECD countries in the range of half the value calculated by the World Bank and the IFC for other world regions. The figures for the OECD-average in 2006 were 6.9 documents and 3.3 signatures to be submitted on the import side, with an indicative time for importing of 14 days.[98]

2 Protectionist measures in contradiction with basic GATT principles

The Multi-Fibre Arrangement[99]

For decades, the competition from developing countries using their comparative advantage in low-cost labour was considered to threaten jobs in the labour-intensive T&C sector. Already in the 50', Asian low-cost countries agreed to introduce voluntary export restraints for cotton textiles to the US. In 1962 the Long Term Agreement Regarding International Trade in Cotton Textiles (LTA) entered into force, and was later renegotiated and replaced by the Multi-Fibre Arrangement (MFA) in 1974. A system of bilateral quota

[98] The quoted UNCTAD publication provides actual and detailed indications.

[99] The text of this paragraph is essentially taken from Andersson, Anna (2009): Made in Madagascar – The impact of rules of origin on the textile and clothing industry, Department of Economics, University of Lund, Study Series 193

agreements was set up that violated the principles of the multilateral trading system in several ways: it used quantitative restrictions instead of tariffs, it violated the most favoured nation principle, it discriminated against developing countries and it was non-transparent. It was only in the Uruguay Round when the dismantling of the MFA succeeded. The Agreement on Textiles and Clothing provided for the gradual abolition of the quotas that existed under the MFA. This process was to be completed by 1 January 2005.[100]

Antidumping and Safeguard Measures[101]

However, not only large tariffs remain in place on many textile products, there are also three types of WTO sanctioned trade remedy measures that can be imposed, of which the anti-dumping measure is the most pernicious. T&C imports from relatively competitive countries like China, India, Pakistan and Turkey have been routinely subjected to anti-dumping investigations in the past. Bed linen has been one of the most targeted products by the EU, presumably reflecting Portugal's specialisation within the T&C-sector.

The post-quota period has seen the burgeoning of other trade remedy measures alongside anti-dumping ones. Temporary safeguards on Chinese imports is a case in point. Although this measure is part of the WTO accession package which China signed onto, it reflects the persistence of the protectionist interest.

While these temporary safeguards expired on December 31, 2008, two other provisions incorporated in China's Protocol of Accession pose a significant burden on China. They are: a) until 2013 it was possible for WTO members to impose "selective" safeguards against any Chinese exports that cause "market disruption"; and b) until 2016 it remained possible to use the "non-market economy" criterion against China to calculate a "dumping margin" in the process of an anti-dumping investigation. This margin inflates the dumping margin, subjecting Chinese imports to a specifically high anti-dumping duty.

Non-tariff Barriers to trade

The risk is that the traditional barriers such as tariffs, quotas and voluntary export restrictions may be replaced by a new form of regulatory barrier, non-tariff barriers to trade (usually abbreviated NTMs, M for measures), of which technical obstacles to trade (TBTs, B for barriers) are the most developed category. A large fraction of these TBTs covers intermediate inputs. Owing to their technical complexity and political invisibility, product norms are often written, directly or indirectly, by domestic firms to which they apply. Quite naturally, these firms write the norms in a way that favours their varieties or at least disfavours foreign varieties of a category of products. Imposition of regulatory and standards-related barriers on T&C products has been limited when compared to sectors where health and environmental standards play a major role, but the future looks uncertain. A particularly elaborate and complex system with possible trade-restrictive effects may have been erected by the EU, called REACH (Registration, Evaluation and Authorisation of Chemicals).[102] The REACH legislation subjects textiles and clothing firms to a procedure of registration, evaluation, authorisation and restriction for a large number of chemical substances.

The arsenal of NTMs goes beyond TBTs. Several international organisations have elaborated the UNCTAD-MAST classification of NTMs shown in the table below. Burdensome administrative procedures are the main category of obstacles to trade that qualify as NTMs without being TBTs. Private standards, differing from firm to firm, can also constitute costly barriers. Due to pressures from consumer groups, the environmental lobby and trade unions, some of the major buyers in developed countries have private "codes of conduct", which they expect all suppliers to follow. While there is sufficient evidence that the exercise of buyer power is important in securing environmental and labour standards, it is an open question whether they have to correspond to those in the developed world. What certainly needs to be avoided is that multiple codes with different monitoring and reporting requirements are imposed on a single producer. The latter situation is more than an eventuality, however.

[100] It actually happened only then and thereafter. See next paragraph.

[101] The text of this paragraph is essentially taken from Adhikari /Yamamoto (2007).

[102] Dressings applied to textiles are one critical point. See e.g. http://www.academia.edu/1591105/The_Compatibility_of_REACH_Regulation_with_WTO_TBT_Agreement

Imports	Technical measures	**A** SANITARY AND PHYTOSANITARY MEASURES (SPS) **B** TECHNICAL BARRIERS TO TRADE **C** PRE-SHIPMENT INSPECTION AND OTHER FORMALITIES
	Non technical measures	**D** CONTINGENT TRADE-PROTECTIVE MEASURES **E** NON-AUTOMATIC LICENSING, QUOTAS, PROHIBITIONS AND QUANTITY-CONTROL MEASURES OTHER THAN FOR SPS OR TBT REASONS **F** PRICE-CONTROL MEASURES, INCLUDING ADDITIONAL TAXES AND CHARGES **G** FINANCE MEASURES **H** MEASURES AFFECTING COMPETITION **I** TRADE-RELATED INVESTMENT MEASURES **J** DISTRIBUTION RESTRICTIONS **K** RESTRICTIONS ON POST-SALES SERVICES **L** SUBSIDIES (EXCLUDING EXPORT SUBSIDIES UNDER P7) **M** GOVERNMENT PROCUREMENT RESTRICTIONS **N** INTELLECTUAL PROPERTY **O** RULES OF ORIGIN
Exports		**P** EXPORT-RELATED MEASURES

3 Tariff concessions granted through preferential trade agreements matter

Tariff concessions granted to a single or a selection of trading partners have two effects: they are trade generating and trade diverting, a point that we will now develop.

In principle, to grant tariff concessions is in contradiction with the Most Favoured Nations Principle. However, the WTO agreement allows for the conclusion of agreements granting tariff concessions to specific trading partners. Two reasons may be advanced as an explanation. The first is that regional agreements are creating trade. While not benefiting all countries, they at least withdraw some or eventually all protection from the domestic industry; they act in the right direction. Second: Free Trade Agreements can constitute a compensation for the fact that smaller countries experience more difficulties in exploiting economies of scale when faced with tariffs on their exports. To some extent, this is reflected in their denomination since Free Trade Agreements are also called regional agreements (albeit in recent years, the limitation of such agreements to countries located on the same continent got more and more lost). The view that the MFN exception for FTAs is based on considerations of economies of scale is further corroborated by the essential requirement regional agreements have to comply with in order to conform WTO rules: they have to cover essentially all trade. So, in a way, they are there to mimic the expansion of markets a customs union provides, the latter knowing – theoretically - no internal but only external barriers.[103]

If MFN rates are sufficiently high, preferential rates can significantly distort trade. They come with a cost to global welfare. The most efficient producer is replaced by a less efficient producer

[103] A Customs Union (CU) differs from a FTA by the fact that a CU has a common external tariff scheme. Typically, a CU constitutes as such a member of the WTO and not indirectly, through membership of its single members. This principle is however handled in a flexible way as the EU for a long time was not entitled to represent members in negotiations on services.

benefitting from preferential treatment. This fact is called trade diversion. A free trade agreement of Switzerland with the US as examined in 2005 would have stolen the EU a lot of business and would certainly have led to requests by the EU to be offered a similar treatment in the field of agriculture as would have been negotiated with the US.[104] Countries with less negotiating power can not ask for a complementary agreement when suffering from trade diversion and will also often not have the necessary resources and rate of return in negotiating such an agreement. The discretion of countries in choosing with whom to negotiate FTAs is certainly objectionable. To complete the picture regarding FTAs, it may be noted that a new form of MFN clause has arisen: Those countries having already a FTA can often claim based on this FTA that negotiations have to start regarding the extension of any beneficial treatment the partner country is offering a third country in the respective FTA.

It is an ongoing debate whether the wave of free trade agreements and such clauses are a stepping-stone towards a further liberalisation of trade on the global scene or whether this evolution is a stumbling block to liberalising world trade. Countries linked by FTAs with their essential trade partners may lose interest in extending benefits on an MFN basis through a WTO agreement, but once FTAs cover a large share of their trade, applying zero rates on all imports would cost little in terms of customs revenues and save a lot of administrative costs. The latter argument was not yet really valid for a long time, however, since there were no FTAs between the six biggest trading nations. The eventual conclusion of a FTA between the USA and the EU, called Transatlantic Trade and Investment Partnership (TTIP), is likely to create a call for an extension of the preferences accorded in an EU-USA-agreement to a series of other countries. The smaller partner countries in NAFTA and EEA have to a limited extent already prepared such an extension since the EFTA countries have an FTA with Mexico and Canada and this would create already some nuisance potential for the EU and USA.

Under the heading of preferential trade schemes, additional to FTAs the Globalised System of Preferences (GSP) and similar national Acts need also mentioning. In principle, FTAs are symmetrical albeit transition periods may differ. Symmetric means that the participating countries move in comparable steps to the zero tariff rates that conceptually make up a FTA.[105] In the interest of promoting trade by less developed countries, unilateral or, at least, asymmetrical tariff concessions were granted to countries outside the developed world.

The most important preferential scheme with a development dimension is the GSP, the Generalized System of Preferences. Selected products originating in developing countries are granted reduced or zero tariff rates over the MFN rates. The GSP was adopted at UNCTAD II in New Delhi in 1968.[106] By way of the ‘enabling clause’, the scheme was integrated in the GATT framework.[107] Countries with progressing per capita income risk to loose eligibility for GSP (according to non-discriminatory criteria defined by the importing countries) and have therefore an interest in replacing GSP preferences by FTA’s. Chile is an example.

The Cotonou Agreement is a treaty between the European Union and the African, Caribbean and Pacific Group of States ("ACP countries"). It was signed in June 2000 in Cotonou, Benin's largest city, by 78 ACP countries (Cuba did not sign) and the then fifteen Member States of the European Union. It entered into force in 2003 and was subsequently revised in 2005 and 2010. Probably the most radical change introduced by the Cotonou Agreement compared to the preceding Lomé

[104] Gary C. Hufbauer, Richard E. Baldwin: The Shape of a SWISS-US Free Trade Agreement, Institute for International Economics, Washington, 2005. Particularly in the meat market, the US would have substituted – after a long transition period - the EU for a trade volume of several hundred million US-$ a year. To conclude such an agreement would have meant for Switzerland to reintroduce veterinary border controls, an alleviation the EU and Switzerland had negotiated before, one core reason being that the EU do not want hormone treated meat on their market. This is an illustrative example of a not necessarily anticipated interaction of tariffs and NTBs, the latter having in the end limited Switzerland freedom in choosing FTA partners.

[105] The China-Switzerland FTA confronted negotiators with old challenges in a new way in the sense that China wanted to use the margin the world “essentially” leaves with regard to full trade liberalisation also in the area of some manufactures and not only in the area of agriculture. As in prior times when in the ‘consultative tariffs commission’ such bargains were negotiated among involved industries, the responsible government services had to reach a compromise regarding which industry will be left to pay some duties. In the end, also due to China’s requests, it was watchmaking.

[106] For more information see http://unctad.org/en/Pages/DITC/GSP/Generalized-System-of-Preferences.aspx

[107] https://www.wto.org/English/docs_e/legal_e/enabling1979_e.htm

Convention concerns trade cooperation. Since the First Lomé Convention in 1975, the EU has granted non-reciprocal trade preferences to ACP countries. Under the Cotonou Agreement, however, this system was replaced by the Economic Partnership Agreements (EPAs), a new scheme that took effect in 2008. These new arrangements provide for reciprocal trade agreements, meaning that not only the EU provides duty-free access to its markets for ACP exports, but ACP countries also provide duty-free access to their own markets for EU exports. In conformity with the Cotonou principle of differentiation, however, not all ACP countries have to open their markets to EU products after 2008. The group of least developed countries is able to either continue cooperation under the arrangements made in Lomé or to use the "Everything But Arms" regulation. Adopted on 26 February 2001, the EBA Regulation (Regulation (EC) 416/2001) grants duty-free access to imports of all products from least developed countries (UN list) without any quantitative restrictions, except for arms and munitions. Non-LDCs, on the other hand, who decide they are not in a position to enter into EPAs can for example be transferred into the EU's Generalized System of Preferences (GSP), or the Special Incentive Arrangement for Sustainable Development and Good Governance (GSP+).

In North America, unilaterally determined non-reciprocal preferential trade schemes include: (i) the Caribbean Basin Economic Recovery Act (CBERA), often referred to as the Caribbean Basin Initiative (CBI), promulgated by the United States in favour of 24 (among 28 eligible) Central America and Caribbean countries and territories washed by the Caribbean Sea; (ii) the Andean Trade Preference Act (ATPA) promulgated by the United States in favour of Bolivia, Colombia, Ecuador and Peru; and (iii) from the Canadian side, the Trade, Investment and Industrial Cooperation programme (CARIBCAN) enacted in favour of 18 Commonwealth Caribbean countries and territories. Furthermore, a US African Growth and Opportunity Act (AGOA) was signed into law by President Clinton in May 2000 with the objective of expanding U.S. trade and investment with Sub-Saharan Africa. As of August 2014, 41 Sub-Saharan African countries were eligible for AGOA benefits. In 2013, about 91 percent of U.S. imports from AGOA-eligible countries entered duty-free, either under AGOA, GSP, or zero-duty MFN-rates.

That FTAs matter is further elaborated in section 3.5, after having explained an important feature going along with FTAs, namely preferential rules of origin (plus cumulation).

4 The articulation of Rules of Origin (RoO)

Two types of Rules of Origin (RoO) exist, non-preferential and preferential.[108]

- Non-preferential RoO are simply used to determine where a product is produced. They are a way to separate domestic from foreign products so that for example safeguard measures and origin marking can be used. Trade statistics can more easily be established and by indicating the country of origin an information valued by costumers can be provided.
- Preferential RoO, on the other hand, are used in a preferential trade agreement (PTA) to establish if products exported from one member to another qualifies for preferential treatment in the form of better market access. The better market access usually comes in the form of a lower customs tariff, or in the case of a Free Trade Agreement (FTA), a tariff-free entry.

We reproduce on the next page an excerpt out of the Swiss Ordinance on the Certification of the Non-Preferential Origin of Goods (OCG; RS 946.31[109]) of 9 April 2008. This ordinance was adopted by the Swiss Federal Council inter alia in implementation of the Agreement of 15 April 1994 on Rules of Origin (Annex 1A.11 of the Agreement Establishing the World Trade Organisation). The WTO indeed requires that each country has such a set of rules.[110]

The distinctions and criteria used in preferential RoO are not categorically different from the non-preferential rules shown here, but much more elaborate and differing from one agreement to the next, so that they cannot be reproduced here. A comment on the non-preferential rules suffices to understand their working, however.

[108] The wording is partly from Andersson (2009).

[109] See https://www.admin.ch/opc/en/classified-compilation/20072514/index.html

[110] In principle, non-preferential rules of origin are also there to distinguish between imports originating in WTO member states and those from outside the WTO. That for Non-WTO-members, specific tariffs different from the MFN rates are enacted appears to be rarely the case so that the usage of non-preferential RoO as indicated above appears to be more important.

Section 2: Origin Criteria

Art. 9 Swiss origin

A product shall be considered to be of Swiss origin if it either has been wholly obtained or produced or has been sufficiently worked or processed within the territory.

Art. 10 Wholly obtained or produced

The following shall be considered to be wholly obtained or produced within the territory:

a. *mineral products extracted from its soil;*
b. *vegetable products harvested or obtained from vegetable cell cultures there;*
c. *live animals born or hatched and raised there;*
d. *products derived from live animals raised or from animal cell cultures there;*
e. *products of hunting or fishing conducted there;*
f. *products of sea-fishing and other products taken from the sea and caught by Swiss vessels;*
g. *goods produced on board Swiss factory ships solely from the products referred to in subparagraph (f);*
h. *used articles collected there for the purpose of recovering raw materials;*
i. *waste and scrap resulting from manufacturing operations conducted there ;*
j. *produced exclusively from the products specified products produced there exclusively from products referred to in subparagraphs (a) to (i).*

Art. 11 Sufficiently worked or processed

1 *A product shall be considered to be sufficiently worked or processed if:*
   a. *the value of all materials of foreign origin used in its production does not exceed 50% of its ex-works price;*
   b. *on account of working or processing, it has to be classified under a heading in the Harmonised System different from the one applicable to the products of foreign origin used in its production;*
   c. *or possible specific origin-conferring processing or working has been undertaken in accordance with paragraph 2.*

2 *The FDEA may define specific origin-conferring working or processing for particular products. It may exclude the applicability of paragraph 1 letters a and b for certain of these products.*

3 *Tolerance rules may be specified for products falling under paragraphs 1 letter b and 2.*

Art. 12 Materials originating within the territory

1 *A product that has been sufficiently worked or processed within the territory and which is used in the production of another product shall be considered to be a material of Swiss origin. It is irrelevant whether the material was produced in the same or in another business.*

2 *Materials of foreign origin that have been used in the production of a domestic material under paragraph 1 are not to be taken into account when determining the origin of the other product.*

Art. 13 Insufficient working or processing

The following are considered insufficient for conferring originating status:

a. *treatments intended to keep the products in the same state during transportation or storage (ventilation, dispersion, drying, cooling, freezing, immersion in brine or water containing sulphur or other added substances, removal of spoiled parts and similar treatments);*
b. *simple dust removal, sieving, segregation, classification, sorting (including the making of assortments), washing, painting, cutting up;*
c. *simple packing work, specifically:*
   1. *the replacement of packaging binders, the division or assembly of packing units,*
   2. *simple placing in bottles, cans, flasks, bags, cases, boxes, fixing on boards and , vacuum-packing and enclosure in a controlled atmosphere;*
d. *applying brand names, labels or other similar distinguishing marks to the products themselves or to their packaging;*
e. *simple mixing of products, including different types of products, if one or more elements of the mixture do not meet the conditions for products with originating status;*
f. *simple assembly of parts into a complete product;*
g. *the combination of two or more operations specified in letters a to f;*
h. *the slaughter of animals and the cutting up of meat (disjointing, shredding and chopping).*

As the Swiss example of RoO shows, a primary distinction is made between products that are *wholly obtained or produced* or which have been *sufficiently worked or processed within the territory*. In the first category we primarily find products of agriculture and the extractive industries in their raw form. Most traded goods are processed, however, making it essential how the requirement of a substantial transformation in the exporting country is defined and handled. There are three main ways and different tests to determine this.[111] Sometimes a combination of tests is necessary to establish origin.

- The first possible test is a *change in tariff classification* according to the Harmonised Tariff Schedule between the input and the exported good. This can be more or less strict depending on how extensive the change must be. The change in tariff classification rule can demand that due to the processing the product alters its attribution to a chapter (2-digit level), a heading (4-digit level), a sub-heading (6-digit level) or an item (8-10-digit level). Obviously, a change at the chapter level is the strictest of these versions.
- The second test is *value content* which means that a certain percentage of value must have been added to the product to get origin status. This criterion can take three different forms: a) import content test: imported inputs are not allowed to exceed a certain percentage of the final good's value; b) domestic content test: a minimum percentage of local value must be added in the last country where the product was processed; c) value of parts test: originating parts must account for a certain percentage of the final good's value. The exact percentage differs between trade agreements and products but the percentage used in the import content test is usually around 40%.
- The third test is a *specific process rule* which requires the product to undergo (positive test) or not undergo (negative test) a certain manufacturing process in the originating country.

There are advantages and disadvantages with all three tests. The change in tariff classification test has the advantage of being relatively simple, easy to apply and it could be used uniformly across countries. Difficulties, on the other hand, are applying a commodity classification designed for several purposes and the habit of having lists of exceptions when it comes to this rule. The value content test is potentially quite costly since it requires decisions on how to value inputs and knowledge of domestic production costs but might be uniformly applied across all product categories. The advantage of the specific process rule test is that it can be adjusted to any special case. However, it is very difficult to construct technical tests for every product. It is also hard to verify information in order to determine which process actually took place in third countries so that this test can easily be manipulated.

The increasing importance of RoO due to globalisation and an increased number of FTAs meant an increased attention for their articulation and effects. In particular their supply-switching effects through inflexible input sourcing rules and administrative costs have been found to have a negative effect on trade. For the former point see section 5. To illustrate the latter point, i.e. the administrative burden, the metaphor of the spaghetti bowl has been created.[112] Since RoO differ from agreement to agreement, virtually every country concluding FTAs is linked to the other countries concluding FTAs by an individual pipe, a "spaghetti", instead of producing in a common bowl of soup from where everybody is served. The heterogeneity of RoO of course negatively affects the usage made of FTA provisions.

Finally, there exist some complementary rules, used in combination with one or several of the above tests, to make RoO less restrictive. One possibility is that the importer may choose among the three alternative ways of formulating RoO (to the extent the alternatives had been worked out). Cumulation rules, on the other hand, allow producers to use inputs from certain countries without losing the preferential status given to them in a FTA. This cumulation can be bilateral, diagonal or full, and there is a new version, cross cumulation:

- Bilateral cumulation is the most common form and operates between two FTA partners. Partner A can use inputs originating from partner B in exports to partner B as if they were A's own, and vice versa, without affecting the final good's origin status.
- Diagonal cumulation means that beneficiary countries that are members of the same preference program can use inputs originating from each other and still be granted origin status for the final product.
- Full cumulation is the least restrictive form and extends diagonal cumulation. Here, countries tied together by the same preferential origin rules can use goods produced in any part of the area, even if they were not originating products. All processing done in the

[111] The wording is partly from Andersson (2009).

[112] The term was coined by Jagdish Bhagwati. See Bhagwati, Jagdish N. (1995): US Trade Policy: The Infatuation with FTAs, Columbia University Economics Department Discussion Paper Series No. 726, New York

preference area is counted against the fulfilment of a value criterion, e.g..

- Cross cumulation: Distinct from diagonal cumulation, a requirement that the involved bilateral free trade relations know identical RoO is no longer upheld. If imports from Peru enter Switzerland duty free under the Peru-Swiss FTA, these imports may be used like inputs from within Switzerland when it comes to qualify for duty-free importation into Canada under the Swiss-Canada FTA, simply based on the fact that there exists also a Peru-Canada FTA and that the RoO in the three FTAs are considered equivalent.

5 FTAs may be a mixed blessing

There is no doubt that preferential market access – either through a free trade agreement (FTA) or schemes favouring less developed nations – has helped some countries in their development.[113] Jordan, a country largely unknown regarding its prowess in textiles and clothing, has e.g. emerged as a significant player in this industry only after its 2001 free trade agreement with the United States. Jordan's clothing exports to the United States increased from a mere US-$ 43mio in 2000 to US-$ 1.1bio in 2005. In contrast, the value of Jordanian exports to the EU, where the country did not enjoy duty free market access, had only been US-$8.8mio in 2005. Other evidence shows, however, that impacts of PTAs have been, at best, mixed as far as the export performance of the preference receiving countries is concerned. For example, Bangladesh has been able to use the duty-free-quota-free market access treatment to the EU provided under the "Everything but Arms (EBA)" initiative to the benefit of its knitted apparel exports, with the preference "take up" rate of 80 per cent. In the segment of woven items, the country has not been able to register significant export growth, and Rules of Origin may have been the reason.

A specific example of the impact of rules of origin (RoO) is studied by Anderson,[114] namely their impact on the Malagasy textile& clothing industry. The case is interesting since related to Malagasy clothing exports and textile imports, RoO of two different preferential trading arrangements for developing countries may be compared, the US African Growth and Opportunity Act (AGOA) and the Lomé/Cotonou agreement of the EU.

The history of Madagascar as a producer of textiles and clothing started with switching from an import substitution policy to promoting exports by creating an EPZ. The expansion of the EPZ was at the start driven by French investors who were attracted by the many French-speakers among the Malagasy population and by an already large French community. In a second stage, Madagascar evolved in the footsteps of Mauritius. When wages rose in Mauritius and a US quota restriction on Mauritian imports was introduced, Mauritian investors looked for a suitable place to relocate. Madagascar was chosen due to its proximity to Mauritius, the high productivity of Malagasy workers, the French-speaking population, no quota restrictions and the low labour costs. A third phase of investment inflow came from Asia in the late 90' in relation to the entry into force of AGOA in 2000. Production abroad was a way for Asian producers to circumvent the textile quotas they faced at home. The choice of Madagascar was again motivated by the EPZ, low labour costs and by preferential access to both the EU and the US. The nationalities among EPZ owners in 2008 were French (29%), followed by Malagasy (20%), Mauritian (16%) and Chinese (12%).

The overall positive effect is mitigated by the impact on sourcing, however. The value added in sewing may turn out to be insufficient or other aspects of the RoO may not be fulfilled by the transformation in the country, so that inputs which may count against the fulfilment of RoO need to be added to benefit from preferential rates. Anderson finds that the AGOA RoO are more liberal than the ones in Lomé/Cotonou, especially when it comes to input sourcing. The study then goes on to show that strict RoO have a negative impact on Malagasy clothing exports. Clothing exports to the EU tended to grow slower, be less diversified and use less diversified inputs than exports to the US. Furthermore, strict RoO are not found to increase vertical integration in the Malagasy textile and clothing industry.[115] In conclusion, the limited input sourcing possibilities in the Lomé/Cotonou RoO can be said to have limited the expansion and diversification possibilities of the Malagasy textile and clothing industry. It can be questioned whether using strict RoO as a tool for development policy – the idea is to favour local sourcing - in highly fragmentized sectors is effective.

Further indications regarding the effects of FTA, RoO and cumulation are provided by a study

[113] Adhikari, Ratnakar and Yumiko Yamamoto (2007): The textiles and clothing industry: Adjusting to a post quota world, in UN, Department for Economic and Social Affairs: Industrial development for 21th century, NY

[114] Andersson, Anna (2009): Made in Madagascar – The impact of rules of origin on the textile and clothing industry, Department of Economics, University of Lund, Study Series 193

[115] This means that the production of fabrics out of yarn was not shifted to Madagascar.

Olivier Cadot, Christopher Grigoriou and Bolormaa Tumurchudur elaborated in 2008 on behalf of the Swiss State Secretariat for Economic Affairs.[116] They examine in detail textile trade between respectively Morocco, Tunisia and Turkey on the one and Switzerland on the other hand. To this end, they codify i.a. the rules of origin pertaining to Switzerland in the area of textiles and clothing (HS chapters 50 to 63). The following table indicates the complexity of these rules. This complexity is not specific to EFTA rules of origin, they generally are as elaborate, at least in this sector. Actually, the indications in the table regarding Switzerland should be identical to those of the EU since diagonal cumulation is allowed between Morocco, Tunisia, the EU and Switzerland. Applying penalty points to each requirement according to its presumed strictness allows to calculate aggregate measures of the tightness of rules of origin. These values may then be entered as explanatory variables in regression equations. In the estimation part of the study, the authors apply a gravity model and find that the trade volume is to a considerable extent driven by the quality of the road system in the exporting country; this variable dominates in importance over tariff protection. However, with regard to tariffs, they can establish that rules of origin favour sourcing in the territory of the FTA-partners. Finally, they address cumulation, arguing that the tighter RoO are, the more the aspect of cumulation becomes important. Drawing on work done at the IADB, they show that the Euro-Med RoO are the strictest.

Quantitative estimates of what cumulation can cause in terms of trade creation and diversion is provided by Gasiorek, Augier and lai-Tong (2009).[117] They use the introduction of the Pan-European Cumulation System (PECS) in 1997 as a natural experiment, possibly exhibiting directly the impact of rules of origin. They draw on a prior study (Augier, Gasiorek and Lai-Tong (2005)) employing the gravity modelling framework to examine the impact of the introduction of the PECS on the newly cumulating countries over time. The results in this study suggested that the introduction of cumulation served to increase trade between spokes by between 7% - 22%, and that trade was potentially lower between those

Types of Rules of Origin requirements affecting trade in textiles and apparel

HS chapter	no. of lines	WH	TECH	Change chapter	Change line	Change subdiv.	Except. subdiv.	Except. chapter	Allow,	foreign content	Altern. rule
50	10	0	80	0	90	0	70	0	0	30	30
51	38	0	53	0	100	0	53	0	0	29	29
52	131	0	96	0	96	0	96	0	0	59	59
53	29	0	48	0	100	0	48	0	0	24	24
54	66	0	100	100	0	0	0	100	0	52	52
55	115	0	100	76	24	0	24	76	0	59	59
56	3	0	100	100	0	0	0	100	0	12	0
57	23	0	100	100	0	0	0	100	0	13	0
58	41	0	88	88	12	0	0	88	0	98	88
59	24	0	100	96	4	0	4	96	0	21	21
60	44	0	100	100	0	0	0	100	0	0	0
61	116	0	100	100	0	0	0	100	0	0	0
62	119	0	99	99	1	0	0	99	0	58	56
63	59	0	88	88	5	0	0	88	0	64	58
Total	*848*	*0*	*94*	*71*	*28*	*0*	*23*	*71*	*0*	*42*	*40*

The entries in the table indicate the percentage of lines within a chapter affected by a requirement (an exception is the 2nd last column). WH means the requirement 'wholly obtained', TECH signals that a certain technical transformation is required, the next 6 lines refer to a required change in the tariff position, either at the chapter level, the level of a tariff line (HS 6 digit) or the level of the subdivisions of a HS 6 position, 'except.' and 'allow.' indicate that for some lines within a chapter special requirements regarding the change in tariff position apply, 'except.' making the regime more stringent, 'foreign content' indicates the maximum allowed in percentage terms and 'altern. rules' captures whether exporters may choose between criteria TECH, foreign content and change in tariff position.

[116] Olivier Cadot, Christopher Grigoriou and Bolormaa Tumurchudur: Préférences et règles d'origine dans le secteur textile-habillement : La Suisse et la zone Euro-Med, p. 205-328, in Peter Balastèr, Chantal Moder (ed.): Sur la voie du bilatéralisme - enjeux et conséquences (volume 2), Reihe Strukturberichterstattung 36/2, Swiss State Secretariat for Economic Affairs, Berne, 2008.

[117] Gasiorek, M., Augier, P. and Lai-Tong, C. (2009), "Multilateralising regionalism: lessons from the EU experience in relaxing rules of origin", in Baldwin, R. and low, P. (eds), Multilateralizing Regionalism: Challenges for the Global Trading System, Cambridge, UK: Cambridge University Press: 146-181.

countries which were not part of the PECS system by up to 70%. The study of 2009 used more comprehensive data. The estimations were based on trade flows between 38 countries - all of the EU countries, the EFTA countries, the CEFTA countries, the Baltic States, 6 countries taking part in the Barcelona process (Turkey, Jordan, Israel, Egypt, Tunisia, Morocco), as well as USA, Canada, China, Japan and Australia. The regressions were carried out using total trade, manufacturing trade, and intermediate goods trade for the years 1995-1999. Regressions were run for 28 industries and the coefficient reflecting cumulation turned out to be positive in 13 to 18 cases, according to the exact equation estimated. The industries where the coefficient was consistently positive are food manufacturing, textiles and wearing apparel. The coefficient values suggest that cumulation served to increase trade by between 14% and 72% across the different industries and control groups. The biggest impact of cumulation is on wearing apparel, leather products, fabricated metal products, and electrical machinery.

Overall, FTAs constitute a mixed blessing since they comprise the risk of non-sustainable specialisation. This risk is the more pronounced the more restrictive RoO are and the less the latter are attenuated by cumulation provisions. Empirical estimates confirm the relevance of these provisions which, to the uninformed observer, appear primarily as a highly technical matter. Accordingly, different proposals have been made to alleviate the burden put on sourcing by RoO. An interesting approach is cross-cumulation. Essentially, cross cumulation assumes that the RoO among a set of FTAs are equivalent. An instant soup sachet produced in Switzerland from Peruvian asparagus could then be sent to Canada while Swiss machine parts could be used in Canadian mining equipment sent to Peru without caring about an eventual loss of origin and therefore of preferential tariffs although the three countries are linked by three separate FTAs and not a common one with common RoO. Cross cumulation was studied on behalf of the Swiss Sate Secretariat for Economic Affairs by Murray G. Smith from Ticon Development Consulting.[118] According to the author, the group of Canada, Colombia, Peru, Mexico and Switzerland is an obvious target for eventually negotiating cross-cumulation since Canada is already exploring such a regime with Colombia and Peru.

Not all these countries may be willing to go forward at this time, however, and this may even be more of a problem when cross-cumulation were to be negotiated with dominant trading nations. It is evident that extending cross-cumulation to EU-FTAs that overlap with Switzerland's network of FTAs would be of high priority in light of the significance of the EU in the external trade of Switzerland. Yet, after the rejection of becoming an EEA member in 1991, Switzerland waited years to benefit from Pan-European cumulation, and today the situation is as difficult as twenty years ago. Furthermore, the FTA-partner(s) of Switzerland would also have to agree and been linked by a suitable FTA with the EU. Most likely, trade facilitation by way of cross-cumulation will have to wait, and not only in this case since it is often the protection-seeking industry itself which imposes these complicated RoO. Other stakeholders in FTA negotiations hardly know about them and are even less in a position to appreciate what their precise articulation signifies at the company level. The economic significance of what is negotiated is empirically proven, however.

6 Trade facilitation

Concluded at the WTO’s 2013 Bali Ministerial Conference, the Trade Facilitation Agreement TFA contains provisions for expediting the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area. The TFA will enter into force once two-thirds of the WTO membership has formally accepted the Agreement. By 17 December 2015, only 63 WTO members had formally accepted the TFA, however. The Trade Facilitation Agreement Facility (TFAF) serves also the interest of developing and least-developed country members since it is estimated that they will capture more than half of the available gains. These countries are given specific assistance needed to reach the ultimate goal of full implementation of the new agreement by all members. According to the WTO’s flagship World Trade Report released on 26 October 2015, implementation of the WTO Trade Facilitation Agreement (TFA) has the potential to increase global merchandise exports by up to $1 trillion per annum.

[118] Ticon Development Consulting et al. (2013): Cross-Cumulation in Free Trade Agreements – Opportunities, Potential and Challenges, Reihe Grundlagen der Wirtschaftspolitik Nr.21, Swiss State Secretariat for Economic Affairs. http://www.seco.admin.ch/dokumentation/publikation/00004/00060/index.html?lang=en

Chapter 5
Financing Government Activities in a Globalised World

1 Taxes as distorting factors of international exchange

In devising an optimal tax system, being it national or international, a first decision to take is whether the tax bill should entirely depend on the economic circumstances of an agent or a transaction or be tied to formal criteria. The answer is clear: The former solution is preferable but unfeasible.

Consider first a consumption tax that should by definition affect only the consumer. Depending on the supply and demand elasticities prevailing on a single market, part of the tax bill will be shifted backwards (if the consumer has to pay the tax) or forward (if collection occurs at the company level). The more supply and demand elasticities differ among markets, the more a consumption tax will not only be a tax on companies to the extent that it is shifted backward or cannot be shifted forward; it will also be a tax applied with different rates to the parties conceptually liable, in accordance with the demand and supply elasticities prevailing on the markets where the companies operate. Expressed differently, taxes distort investment opportunities between economic sectors. To have a different rate per sector is unfeasible, however.

Consider secondly corporate taxation. If shareholder capital needs to be brought up in the home country and is inelastically supplied and credits in host countries are not easily available, limiting leveraging, then the corporate tax collected on earnings of FDI by the foreign country falls largely on the shareholder in the home country. In the opposite case where shareholder capital can be raised in an integrated world market and local credits finance the rest of a direct investment, then above average returns need to be earned on direct investments in the foreign country in order to compensate for a higher tax rate there, and this in particular when foreign earnings are taxed in the home country and the foreign tax bill can only be deducted as a cost component in the home countries tax declaration (i.e. no imputation). The corporate tax is then absorbed by the host country. Which economic entity will finally bear a corporate tax will therefore also to a considerable degree be circumstantial.

However, to correct within the tax regime for demand and supply elasticities with which demand reacts and factors of production are supplied to neutralise market for market the shifting forward or backward of a tax is impossible. The estimation of demand and supply elasticities would remain a subject of ongoing debate and the resulting tax schedule would be so complicated that its applicability would no longer be secured. The conclusion is that in devising a tax system, pragmatism is needed. The heterogeneous effects on sectors of a consumption tax when applying a uniform rate have to be considered as second order nuisance terms that may be ignored and a preference has to be given to transparency and ease of administration (negatively expressed schematism). It is generally accepted that a single VAT rate is preferable. More controversial remains the question of corporate taxation in an international context (see below). But here also, the declared intention of the lawmaker with respect to the economic entity that should bear the tax may not always materialise in practice due to conditions prevailing in the different markets. However, one will have to accept that within certain limits since other solutions create their own distortions or are simply not manageable.

To sum up, it matters whether consumption or income are taxed from an economic point of view, but pragmatic considerations have to take over when fundamental decisions regarding the kind of economic transactions that shall be taxed are taken. Part of the answer to a tax system that is by administrative necessity not free of distortions is an adjustment by the economic agents to the biased economic incentives that result. Authorities would act precipitately if the principles on which a tax system is constructed were thrown over when in single cases the addressee of a tax escapes it. Problems need to reach a certain extent. It is in this vein that the assertion: “Old taxes are good taxes“, ascribed to the German economist Wilhelm Röpke[119] should be understood.

[119] Wilhelm Röpke (1899 – 1966) was one of the spiritual fathers of the German social market economy.

Röpke's reflection is that the costs of the distortions described in terms of economically suboptimal investment have been paid by society and that new taxes will partly annihilate these investments while creating new adjustment costs, supporting a view that problems have to reach a certain magnitude before reform is needed.

What can be retained from Röpke's attitude with a view to globalisation is that international tax coordination efforts can hardly start from scratch but have to build on national and international solutions that are already put in place. Globalisation may however bring shortcomings of current tax practices more clearly to the fore and call for corrective action. The fact that the earning accounts of numerous multinational companies are barely charged with expenditures for taxes while these companies pay substantial dividends is revelatory of wide ranging possibilities for tax planning. Many countries, recently also the U.S., think that the use of such practices has become abusive. Under the heading of "Base Erosion and Profit Shifting" (BEPS), the OECD is examining ways to constrain "too aggressive" tax planning. The notion of "too aggressive" is making it clear from the outset that a fluidum is haunted. Prerogatives based on the economic power of the countries involved are likely to shape the final outcome.

Fortunately, the problem of globalisation affects primarily corporate income taxes. Corporate taxes accounted for 8.7% of government revenues in the OECD in 2011.[120] For other taxes, there is a wide consensus with regard to the question to whom a tax base belongs, as will be shown in the next paragraph. The problem of coordinating taxation internationally therefore remains confined.

2 The allocation of tax bases is setting the framework for DTAs (Double Taxation Agreements)

National and international tax systems converge with regard to the categories of transactions that may be addressed specifically in tax codes.[121] For this reason, fiduciary firms can structure their information brochures on single countries along a common grid: Ranking first is the tax on the earnings of a company that sometimes differs from the one affecting capital gains. Among income from capital, a distinction is operated between dividends, interest, leasing fees and income from intellectual property rights. This pops up when withholding taxes are detailed. Next to consider are tax rates for natural persons on income and fortune and possible alleviations so that the same revenue is not taxed twice, namely at the company level and at the shareholder level which would discriminate against incorporation. In the retained publication[122] then follow social security contributions, consumption taxes of all kind and a series of fees and other levies (costs of registering a car or a lorry, e.g.). What becomes also evident is that, today, the taxation of flows is preferred over the taxation of stocks. Given the difficulties to tax capital gains, most notably when they are not disbursed, the argument to levy a tax on private fortunes as a backstop solution continues to deserve attention, at least in the view of the author.

Generally, the jurisdiction that collects a tax is also the jurisdiction that decides on the spending of the money collected. The attribution of tax bases is therefore the crucial step in coordinating taxation internationally. There is no fiscal equalisation scheme as in federal states that could correct for a problematic assignment of tax bases. Also, enforcement mechanism would remain deficient if it were decided that jurisdictions should commonly asses the taxes due and then share the tax revenue by formula apportionment. The stronger party would remain favoured. Not surprisingly, when rules regarding the international coordination of income taxation were defined in the decade after WWI (see below), the attribution of tax bases has been the major topic. But before addressing the arduous topic of corporate taxation, where the answer remains open, some considerations regarding indirect taxes are appropriate. Indirect taxes are opposed to direct taxes, the latter comprising in addition to taxes on income and fortune (corporate earnings and capital) also taxes on bequests. Indirect taxes are essentially made up of consumption taxes. Fees and royalties are generally considered a third category beyond direct and indirect taxes although these levies may also be called taxes, officially or by the public (see the case of CO_2 taxes).

[120] The OECD Tax Database provides a valuable oversight (http://www.oecd.org/tax/tax-policy/tax-database.htm)

[121] We do not consider here social security contributions. As their name indicate, contributions to these institutions have regularly a social, i.e. a redistributive component. Also, these contributions usually only affect labour. In an overall assessment of the taxation of factors of production one needs to consider the entitlements created by social security contributions and their tax component, a delicate operation as this can only be done using long term growth prospects and knowledge about age dependent income profiles.

[122] The retained publication is EY (Ernst&Young) (2014): Worldwide Corporate Tax Guide, Czech Republic

Many consider the State as the voracious beast (Leviathan) that levies taxes on each and every activity of the citizen up to the point where a further increase in the tax rate leads to reduced public earnings due to the disincentives and behavioural adjustments the tax creates. A benign view of the State seeks to find a rational for collecting a certain tax. Considerations regarding economic growth are the leading idea behind collecting indirect taxes. If income is taxed, the available funds for net investment are reduced so that it is better to target consumption, and this for administrative and possibly incentive reasons (remember Leviathan) by collecting it from the seller, with the effect that consumption taxes are generally indirect taxes (collected by another economic entity than the economic entity that – according to designation - should bear the tax burden). The aspect that such a consumption tax is proportional if not regressive in nature is then compensated by a complementary progressive taxation of individual incomes.

Traditionally, consumption taxes were collected as sales taxes, levied at the point where a good is handed over to the consumer as final customer. Since, as explained, the tax will not entirely be shifted forward, this is tantamount to tax value added at the sales stage heavily. One reason why value added taxes (VAT) have gained popularity is that incentives to disguise the sale or to shift the sales point are significantly reduced by this collection system. By a VAT (value added tax) the difference between earnings and outlays for productive purposes, factor incomes paid excepted, is taxed at every stage of production and commercialisation. Clearly, value added taxes are superior to sales taxes in an international context. A sales point can easily be shifted around, not a value added chain. To the extent that the collection of a VAT has become the global standard, today, at each stage within a global value chains, the jurisdiction where value is created collects some taxes. If VAT is restituted when the good is exported, the jurisdiction finds a compensation in the VAT on imports. [123] If the tax base is sufficiently broad and the rate uniform, with a trade balance in equilibrium, these amounts are of comparable size. Distortions are limited and hardly any international coordination effort is called for. [124]

The important levels the tax rates on consumption and household income have reached make governments think of tapping other activities to increase their revenues. On the revenue side, taxes, fees and levies collected to incentivise certain behaviour plus royalties may be distinguished. By definition, taxes are due without presupposition and as such do not depend nor entitle the person due to pay the tax to call on any specific service rendered by government. Fees are only due when a person calls on a specific service from the government. Levies collected to incentivise certain behaviour range in between. They only entitle the person due to pay this levy to use a good or facility owned collectively. Opposite to fees, any costs of exploitation are paid by the person using the facility. But when usage stops, no levy is due whereas taxes do not depend on actual usage. These incentivising levies may be assimilated with royalties, the latter constituting the price paid for the acquisition or utilisation of a good in possession of the State.

[123] The effects of several VAT rates are complicated and potentially of international relevance. First, it may be noted that when an activity shall be exempt from VAT, VAT needs to be charged on this activity. This has to occur at a rate so high that the VAT calculated on output and the (deductible) VAT on inputs result in an equal amount. Sectors exempt from VAT pay a hidden tax as they are not eligible to claim back the VAT on acquired inputs. The international relevance of different VAT rates appears best in tourism, also due to the fact that for tourism the tax is due where the service is consumed and is not restituted at the border to foreign customers. Furthermore, tourism (i.e. hotels and restaurants) often pays not the normal VAT rate, but a reduced rate. Depending on the difference between the ordinary and the reduced rate and the importance of the inputs to tourism that are taxed with the full rate, the resulting situation can in some countries come close to an exemption of the sector from VAT. The least to say is that the competitive situation among winter resorts in different countries can not only be assessed by looking at the rate charged to the customer. This is but one of a series of intricate points the VAT system knows. Among them, a few have also an international dimension (e.g. carousel fraud).

[124] Within the EU, ambitions go higher. For transactions of goods and services within the Community, a restitution at the border shall no longer occur. An equalisation is made based on macro-economic statistics. While making the application of VAT simpler, the strict EU rules regarding VAT that go along with this coordination mechanisms are not without problems. In particular, there is a minimum VAT rate that must be applied. Still, it may be presumed that VAT rates at the EU minimum level and above remain efficient in a macro-economic sense. The point is that most member states apply tax rates on income that come, in the top range, close to confiscatory levels. This creates an important fiscal coin creating important distortions and the latter possibly outweigh the distortions a VAT in the 20% range creates.

International coordination problems hardly arise with fees since it is clear which government provides them, and usually also with levies and royalties as the community holding ownership over a collective good is usually clear. CO_2 taxes as an example of a levy collected to incentivise a certain behaviour[125] are different since we have a clear international dimension in this particular case. These levies are a royalty for using the regenerative capacity of the atmosphere. Since all nations share the same atmosphere, the aspect of ownership over this collective good must first be cleared.[126] For the system to function well, the global allocation of emission rights to countries has to come prior to the collection of a CO_2 tax.

Internationally, the allocation of tax bases is not intensively debated,[127] except for corporate taxation, raising the question why the taxation of corporate earnings remains an unsettled issue. Is the recognition of an intellectual defeat in constructing an ideal tax system for corporate income really justified and not premature? As we will immediately expose, it is indeed not possible to construct a corporate tax system that simultaneously responds to a number of criteria, each of these criteria established on equally sound reflections.

3 The provisions included in double taxation agreements

The rest of this chapter will be devoted to income taxation, notably to the arduous question of how to tax a company's net earnings. The complexity of the problem makes it necessary to proceed in two steps. We first consider the case where corporate income is disbursed as a dividend to a natural person as the shareholder (or eventually retained within the company in a simple company-shareholder setting). In a second step, we abstract from the question whether an attenuation takes place in the case corporate earnings are disbursed as dividends and taxed a second time as income at the household level and accept as given that companies have to pay taxes on their earnings. Under this proviso, we then concentrate on the question how to tax interrelated companies located in different jurisdictions.

Corporate or shareholder taxation?

Within income taxation, the conceptual debate is ongoing whether economic value shall be taxed where it is generated or with regard to whom it accrues. Economics have a difficult stand in showing what the best solution would be. If ability

[125] Many citizens will assimilate the levy on CO_2 emissions to a tax and may not be wrong in doing so. Past experience suggests that other taxes were not lowered when levies intended to favour certain behaviours were introduced and in the few instances where the proceeds of these levies were restituted to household and businesses through e.g. a lump sum payment per household and a relief on the payroll duties company's pay, politicians tended to tap later in time this flow through public households for some targeted spending. The emphasis of the levy thus shifted from changing relative prices in order to induce a different behaviour (substitution effect) to collect money for the State (income effect).

[126] Royalties on oil and other exhaustible resources are a forth category of government income. But selling the family silver while not acquiring new income generating assets with the proceeds is not a sustainable source of government income. For this reason, we discard here this forth source.

[127] It is true, however, that e.g. France and Switzerland bilaterally disagree on the collection of inheritance taxes (the standard as defended by the Swiss side is that, except for real estate, inheritance taxes are collected at the last residence of the defunct - but what if the defunct had only recently moved out of France to avoid the country's very high inheritance taxes, should not the nationality be considered?) and that the taxation of border workers also occasionally pops up as a contentious issue (labour income but also pay in the arts and sports is taxed at the source, creating two very different questions, namely (i) whether the municipality of residence obtains a share of border workers income taxes as part of an agreement to avoid double taxation, (ii) whether the municipality of residence can attract entrepreneurs and artists by taxing them with a lump sum amount (e.g. five times the rental value of the real estates they inhabit), arguing that they are taxed for the rest of their income at the source while knowing that this only partially holds true. Furthermore, the US stand out with their reservation to article 1 of the OECD's Model Tax Convention on Income and Capital which establishes the applicability of the Convention to 'residents'. The US is alone in reserving its right to tax its citizens and residents, including certain former citizens and long term residents, without regard to the Convention. The opacity of the tax rules laid down by the Internal Revenue Service IRS combined with the huge fines due when an infringement occurs – the latter having been adopted to compensate for the insufficient resources the IRS engages to control the tax declarations that are handed in – are frustrating US citizens (and holders of a green card) living abroad up to the point that some gave up their nationality (resp. their right to establish in the US).

to spend is the criterion, it does not matter where income is generated. If taxes are seen as a non-detailed payment in return to the whole bunch of public goods a jurisdiction provides to an economic agent, the taxation at the source appears as appropriate. As a general tendency, taxes on income earned by companies are considered as a quid pro quo for services rendered, so that the criterion of a production site gains relevance in allocating the tax base. To the contrary, if taxes are collected according to the ability to spend, the place of residence of the spender appears as the appropriate place for taxation. This holds even more so if re-distributional considerations are added and neither a per capita nor a proportional, but a progressive tax shall be collected. First, only households, not companies differ in 'spending ability', so that the owners of profitable companies and not the companies themselves should show solidarity with the poor.[128] Secondly, the re-distributional purpose of taxes makes it also necessary to adopt a comprehensive notion of income, abstracting from the aspect whether a household lives on dividend and interest income, rental payments or wages. This sums up to tax the receiver of a dividend.

Given that countries will hardly refrain from taxing income when it is generated on its soil and given that all relevant nations use taxes for redistribution purposes, the emergence of double taxation (in an economic sense) is unavoidable: Income is taxed a first time when it accrues to companies and a second time when it accrues to households. This classical system, namely to consider companies and households as separate economic units, each with its individual tax bill, may be feasible at low income tax rates. The higher the rates affecting households, the stronger the incentives become to withhold earnings within the company since the increase in the share's value due to retained earnings usually escapes income taxation on a current (i.e. annual) basis. Then, however, primarily the profitable companies decide where net investment occurs and not the final owners, and this may give rise to favour traditional sectors. For this reason, many countries have attenuated the economic double taxation that results when companies and households are both subject of an income tax. Column 2 in the following table from the OECD tax database[129] indicates the numerous solutions that have been chosen in the industrialised world.

Overall statutory tax rates on dividend income 2013

*Here the explanations for the headings in the table: The first column indicates the type of dividend treatment: CL is the **CL**assic solution, MCL the **M**odified **C**lassic **S**olution where dividend income is taxed at a lower rate (notably compared to interest income), FI means **F**ull **I**mputation and PI means **P**artial **I**mputation of paid corporate income taxes on the personal income tax, PIN means that dividend income is **p**arty **in**cluded in the personal income tax base, NST means **N**o **S**hareholder **T**axation of dividends and OTH means **oth**er types of systems (e.g. a normal dividend of 4% tax deductible by the company, i.e. in the range of interest payments which is deductible on the company side). The table then goes on to show the rates affecting companies, households and combined.*

Country	*Type of dividend treatment*	*CIT rate on dist profits*	*Pre-tax dist profits*	*Dist profits*	*Net personal tax*	*Overall PIT + CIT rate*
Australia	*FI*	*30,0*	*142,9*	*100,0*	*23,6*	*46,5*
Austria	*CL*	*25,0*	*133,3*	*100,0*	*25,0*	*43,8*
Belgium	*CL*	*34,0*	*151,5*	*100,0*	*25,0*	*50,5*
Canada	*FI*	*26,3*	*135,3*	*100,0*	*33,8*	*51,1*
Chile	*FI*	*20,0*	*125,0*	*100,0*	*25,0*	*40,0*
Czech Republic	*CL*	*19,0*	*123,5*	*100,0*	*15,0*	*31,2*
Denmark	*MCL*	*25,0*	*133,3*	*100,0*	*42,0*	*56,5*
Estonia	*NST*	*21,0*	*126,6*	*100,0*	*0,0*	*21,0*

[128] A flat rate of the corporate income tax rate, made possible by progressive dividend income taxation, presents the advantage that non incentive is created to over-capitalize a company to bring down the capital return rate.

[129] OECD (2014): OECD Tax Data Base. Corporate and capital income taxes, table II.4, overall statutory tax rates on dividend income

Finland	*PIN*	*24,5*	*132,5*	*100,0*	*22,4*	*41,4*
France	*PIN*	*36,4*	*157,2*	*100,0*	*44,0*	*64,4*
Germany	*CL*	*30,2*	*143,2*	*100,0*	*26,4*	*48,6*
Greece	*CL*	*26,0*	*135,1*	*100,0*	*10,0*	*33,4*
Hungary	*OTH*	*19,0*	*123,5*	*100,0*	*16,0*	*32,0*
Iceland	*CL*	*20,0*	*125,0*	*100,0*	*20,0*	*36,0*
Ireland	*CL*	*12,5*	*114,3*	*100,0*	*48,0*	*54,5*
Israel	*MCL*	*25,0*	*133,3*	*100,0*	*30,0*	*47,5*
Italy	*CL/PIN*	*27,5*	*137,9*	*100,0*	*20,0*	*42,0*
Japan	*MCL*	*37,0*	*158,7*	*100,0*	*10,0*	*43,3*
Korea	*PI*	*24,2*	*131,9*	*100,0*	*35,4*	*51,0*
Luxembourg	*PIN*	*29,2*	*141,3*	*100,0*	*20,0*	*43,4*
Mexico	*FI*	*30,0*	*142,9*	*100,0*	*0,0*	*30,0*
Netherlands	*CL*	*25,0*	*133,3*	*100,0*	*25,0*	*43,8*
New Zealand	*FI*	*28,0*	*138,9*	*100,0*	*6,9*	*33,0*
Norway	*OTH*	*28,0*	*138,9*	*100,0*	*28,0*	*48,2*
Poland	*MCL*	*19,0*	*123,5*	*100,0*	*19,0*	*34,4*
Portugal	*MCL*	*31,5*	*146,0*	*100,0*	*28,0*	*50,7*
Slovak Republic	*NST*	*23,0*	*129,9*	*100,0*	*0,0*	*23,0*
Slovenia	*CL*	*17,0*	*120,5*	*100,0*	*25,0*	*37,8*
Spain	*MCL*	*30,0*	*142,9*	*100,0*	*27,0*	*48,9*
Sweden	*CL*	*22,0*	*128,2*	*100,0*	*30,0*	*45,4*
Switzerland	*MCL*	*21,1*	*126,8*	*100,0*	*20,0*	*36,9*
Turkey	*PIN*	*20,0*	*125,0*	*100,0*	*17,5*	*34,0*
United Kingdom	*PI*	*23,0*	*129,9*	*100,0*	*30,6*	*46,5*
United States	*MCL*	*39,1*	*164,2*	*100,0*	*30,3*	*57,6*

*The table is based on the assumption that globally returns on capital invested will be equalised by market forces **after** company taxes are paid. Therefore, all the entries in column 4 are 100%. The personal income tax rate is calculated after the attenuations for economic double taxation have taken effect. Looking at the entry for Australia, earnings before tax have to be 42.9% higher than the international return on capital in a country when the country collects a 30% corporate income tax, but only 23.5% when a 19% corporate income tax is collected (Czech Republic). The net personal income tax is calculated based on the top marginal rates affecting households in a representative city in the country considered (in Switzerland it is Zurich). Given that dividend income is a relevant source of income only at the top of the income distribution, to show the top marginal rate appears as adequate albeit an increasing importance of funded pension schemes for average earners mitigates the picture.*

In order to add an international dimension to this table, it is important to note that almost all countries in the table apply a withholding tax on dividends and most countries also on interest payments and often so also on license fees. The owners of shares, bonds and IPRs living abroad can claim back the withholding tax or, if not or in case of only partial restitution, may then regularly benefit from imputation of the income withheld on their national tax bill. However, this is only the case when the country where the capital income is generated and the country of residence of the capital owner have concluded a Double Taxation Agreement.[130] Furthermore, the solutions offered by DTAs tend to remain imperfect, time consuming and costly, contributing to the home bias in

[130] Eventually, if this is not the case, a conduit company located in a country having double taxation agreements with both the source and the residence country can overcome the difficulty. Notably holding companies may assume the role of a conduit company albeit their economic functions are larger. Such constructions belong to the corporate sector (see below). They may be used directly by entrepreneurs holding a dominant stake in a series of domestic and foreign companies.

investment decisions that may be observed throughout the world. An alleviation for foreign investments by households, but also by companies, is therefore worth mentioning, namely to set up economic entities, usually called funds, that are “transparent” from the fiscal point of view. Such funds may collect dividend, interest and licence income from several foreign sources and disburse then the money collected to the holders of the fund’s shares, essentially without qualifying themselves as a taxable economic unit, the direction of the fund informing their shareholders and tax authorities about the source of income disbursed and restitution and imputation possibilities. The activities of the fiscally transparent entities are usually restricted by tax legislation to decisions on financial investments. Such “look through” investment vehicles cannot steer a production unit and are not a response to the taxation of interrelated companies. They may, however, constitute an element in an aggressive tax planning construction of the corporate sector.

It is worth noting that countries will only exceptionally collect taxes for other jurisdictions.[131] As an alternative to taxation at the source, the exchange of information has gained in importance. Switzerland, e.g., practices two different means of exchanging information in tax matters within its international relations. By way of judicial assistance information can be exchanged between the judicial authorities. Judicial assistance is carried out in accordance with the Federal Act on International Mutual Assistance in Criminal Matters (IMAC), the latter transposing the European Convention on Mutual Assistance in Criminal Matters of 1959 in national law. This convention is not confined to tax fraud and Switzerland is about to abolish the exclusion of tax matters from the application of this law. The exchange of information between tax authorities is carried out within the scope of the so called administrative assistance, based upon bilateral double taxation agreements (DTA). For the latter, the OECD model convention with respect to taxes on income and capital sets the standard. Switzerland started to align its DTA network to Article 26 on information exchange of the OECD model tax convention only after having been threatened to figure on a blacklist of tax havens.

It deserves mentioning that the discussion about base erosion and profit shifting has little to do with cases of fiscal fraud. Usually, the schemes utilised conform to the legislation of all jurisdictions involved. To fight them on the basis of an “abuse of law” clause is possible but remains doubtful. To exploit a loophole created by coordination problems among national tax legislations is not per se objectionable. Eventually, one has to carry the argument even one step further. The role vested interests play when legislations and administrations leave loopholes or deliberately open them is not mentioned in any official documents. Still, in the author’s view, the importance of this aspect might be seriously underestimated.[132] Withholding taxes are simply too perfect, it is difficult to apply them not uniformly. Those in power can exercise more discretion when information is exchanged or when an abuse of law clause needs to be invoked. Throughout the world, to discredit only the political opponents by alleging them of fiscal fraud is common, sadly enough.

Taxation of interrelated companies

All the presentations up to this stage were dominated by the case of financial investments by (wealthy) households. Financial funds flowing around the world as portfolio investments are an important aspect of globalisation. However, these investments have nothing or little to do with the setting up of global value chains, today considered to be an essential feature of globalisation. Global value chains usually require that a parent company is creating a subsidiary or is taking a controlling stake in one or more subordinated companies located abroad. This leads to the important question whether the configuration of global value added chains risks to be distorted by corporate income taxation.

Efforts to better coordinate the taxation of companies including parent companies and their subsidiaries date back to the 1920’ies. The rules elaborated in these times built on three sources: proposals elaborated by the International Chamber of Commerce, models developed within the League of Nations and the national tax systems of major countries, namely the US, Great Britain (then a more important foreign investor than the

[131] Switzerland collects a withholding tax on interest paid in Switzerland to EU residents. The offer to collect taxes for other jurisdictions was rooted in the interest to defend the Swiss banking secrecy.

[132] Swiss politics still today prove an astonishing incompetency in understanding the preconditions that upheld the Swiss banking secrecy for many years. It was not only based in Swiss legislation but also upheld by the interest of leading circles in neighbouring countries close to Government of having a possibility to store away hidden money in a financial place offering full-fledged financial services. Anecdotal evidence supports such a view. The public debt crisis in which the industrialised world fell after 2008 and the “democratization” of tax fraud possibilities due to the fact that the internet made it no longer necessary to figure among those who regularly travel abroad and could on this occasion manage a bank account there changed the situation.

US) and France, representing a Continental tradition and possibly (opposite to the US and Great Britain) a net debtor on international financial markets. From the outset, coordination needed to take place among nations that had opted for different approaches for taxing revenue of foreign source (imputation, exemption etc.). A harmonisation of these principles was not only made impossible by the strength of national traditions. A second aspect in this regard is, as already stated at the end of section 2. the fact that it is not possible to construct a corporate tax system that simultaneously responds to a number of criteria, each of these criteria established on equally sound reflections.

To understand the last point, consider in particular the following three criteria:

- Global welfare should reach a maximum despite countries are collecting corporate income taxes at different rates.
- Limited available funds and management capacity of domestic companies should be used to maximise national income.
- The market for corporate control should not be biased by corporate income taxation.

With regard to these three criteria, the literature on international corporate taxation has shown the following:

- the first criterion calls for a solution where the marginal return of capital is equal across countries. This can be achieved if the domestic company pays in the end on foreign earnings the rate applicable on domestic corporate earnings. The global welfare criterion favours therefore a solution with imputation in the sense that taxes paid abroad are deductible from a domestic tax bill established on income earned globally.
- the second criterion favours the solution where corporate taxes paid abroad may only be deducted as costs from the global earnings that are locally taxed. However, the prisoner's dilemma from this form of overt double taxation (less efficient domestic firms are protected from being taken over) should then be mitigated on a contractual basis, i.e. a DTA, between the countries involved.
- the third criterion favours exemption of foreign earnings from domestic taxation. The salient point is that a global capital market with a uniform rate of return is assumed. Domestic companies if they have to pay a tax on foreign corporate income – even if this occurs by imputation - have a disadvantage when bidding for control over existing foreign companies if other countries have opted for the exemption principle.

Critical points are whether one adopts a global or a national view, resp. whether one sees a potential for international tax policy coordination or not, and whether the focus is on (ab-) using the –assumed - scarce resources of domestic companies in the interest of domestic greenfield investment instead of letting companies maximise shareholder value. Relevant is also whether one considers or not that the national interest is best served by attracting headquarters in a world where buoyant refinancing possibilities for domestic companies in a globalised financial market exist and it is important to dominate in the market for corporate control. Clearly, the stage of development and the net debtor/creditor position of a country influence on this appreciation, these two factors being to a considerable degree also interrelated.

We have deliberately chosen the verb "favours". Indeed, an academic debate which is ongoing has shown that the outcome with regard to these three criteria is not as clear-cut as suggested but depends also on a series of circumstantial factors such as capital supply elasticities faced by the actors which will differ from investment project to investment project. The conclusion is that neither a single country nor the international community can devise an optimal but still manageable corporate taxation system.[133]

Clearly, governments will check these three principles against their national interest and against the chances left by the internal political situation to move out of legislation and treaties placing them in a disadvantage. All that shall be said at this point is that a country like Switzerland practising plus/minus the exemption principle and offering low corporate tax rates is an attractive place for locating a headquarter. Additionally, the country is a net creditor towards foreign countries. It will therefore have difficulties to negotiate a 0% withholding tax in DTAs. Other countries will also make a considerable effort to check whether transactions within interrelated companies are not used to make accrue profits at headquarter level. The discussion on base erosion and profit shifting is therefore of direct concern to Switzerland's interest.

[133] For a discussion see Becker, Johannes and Clemens Fuest (2011): The taxation of foreign profits – the old view, the new view and a pragmatic view, Oxford University Centre for Business Taxation, WP 11/04

4 Base Erosion and Profit Shifting (BEPS)

As noted above, the discussion on base erosion and profit shifting is centred about issues arising in conglomerates where owners (or the board) of a company at the heart of the conglomerate[134] have a decisive word to say regarding the prices subsidiaries have to pay for all kind of flows occurring within the conglomerate. In this regard, one has not only to think of intermediate goods sold by one subsidiary within the conglomerate to another subsidiary within this structure. Financing decisions, but also the licensing of intellectual property rights as well as management, consulting and IT services have to be considered as well. There is usually a business reason behind setting up such conglomerates, namely to secure a smooth functioning of the global value chain while building on a knowledge base within the conglomerate that is not or only very partially shared with competitors. However, in the design of these structures, tax considerations are also important.

In the conglomerates we consider, production units in countries with high taxation of corporate net earnings can be economically interesting provided net earnings in these units can be reduced to a low percentage of turnover through a number of flows within the conglomerate on which the subsidiary in question has to rely and which tend to contain a high value added (if they are not outright overpriced). These services are then provided from units within the conglomerate located in countries with low corporate (and manager) income taxation.[135] A type of company that may be set up is a company that is responsible for the steering of the value chain. In this function, the company e.g. detaches managers to subsidiaries, coordinates advertising globally, collects brand and other intellectual property rights for all markets, performs controlling a.s.o.. Another type of company that may be set up is a financing branch where all the interactions of the units in the conglomerate with the financial sector are concentrated. Units in high tax countries will then be highly leveraged as interest paid is tax deductible (opposite to dividend payments); furthermore, the high leverage ratio justifies a high interest rate on the subordinated loans that, then, come from the financing branch. Additionally, loopholes emerging by the interaction of double taxation agreements with e.g. rules regarding imputation of dividend income may be exploited. A number of jurisdictions has offered special company forms where business that is done without touching the territory of the jurisdiction is not taxed or at a lower rate. This may also be exploited. A recent innovation are ‘boxes’. Earnings from IPR when registered in a ‘licence box’ are taxed at a lower rate. The fact that payments for licences may be subject to a withholding tax that is not or only partially restituted in a number of countries may even provide a justification for this kind of box. Also, companies may make use of the tax privileges often granted to holding companies; or conduit companies may be set up, e.g. when double taxation treaties are missing or are not sufficiently attractive to allow a direct flow of funds. The involvement of companies located in a third or fourth country is often an indication of aggressive tax planning.

The countries where income is generated are not deprived of instruments, either. A number of countries has implemented a specific non-resident tax law which unilaterally does not recognize certain (tax-related) structures. The interaction of these laws with DTAs is not always easy to assess and prior rulings on how tax authorities will qualify planned company structures are not obtainable in all jurisdictions. Last but not least, the fact that DTAs differ from one country-pair to the next helps to complicate the situation. Furthermore, there is lack of disclosure of administrative practices.

To give a flavour of the complexity of the topic one may mention that the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of 2010[136] comprises 372 pages and addresses already most of the topics that are currently debated under the BEPS action plan to which we will immediately turn. While it is possible for a person that is not an expert in the field to understand the direction of the actions to be taken, it is not easy to see why the regulations already in place do not do their job. To achieve a

[134] We deliberately use the term ‘conglomerate’ as the picture of a parent company with her subsidiaries would be too narrow. Ownership within the conglomerate may be heterogeneous. There may for instance be companies within the conglomerate where control is exercised by other means than ownership (e.g. intricate contractual relations), perhaps because the country where the unit is located precludes or makes foreign ownership unattractive.

[135] Additionally, in some of these conglomerates, the ownership of the units where profits are concentrated may be disguised by intermitting firms incorporated in tax havens in the Caribbean or similar places.

[136] OECD (2010): Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations http://www.oecd.org/tax/transfer-pricing/transfer-pricing-guidelines.htm

better compliance of nations with the existing provisions (that are only enforceable by putting countries on black lists) is presumably also part of the project.

The report on BEPS was published in 2013 under the responsibility of the Secretary-General of the OECD on behalf of the Ministers of the G20.[137] G20 countries that are not members of the OECD were invited to be part of the project as Associates.

The report takes as its starting point the need of agreed international rules that are clear and predictable. To give certainty to both governments and the international business community is all the more important as the economies become increasingly globally integrated, and so do their companies. Multi-national enterprises (MNE) now represent a large proportion of global GDP. Also, intra-firm trade represents a growing proportion of overall trade. Globalisation has resulted in a shift from country-specific operating models to global models based on matrix management organisations and integrated supply chains that centralise several functions at a regional or global level. Moreover, the growing importance of the service component of the economy, and of digital products that often can be delivered over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. After these general lines follows the pledge that these developments have been exacerbated by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax practices. It is acknowledged that failing to take advantage of legal opportunities to reduce an enterprise's tax burden can put a company at a competitive disadvantage. The report goes on to say that no taxation or low taxation is not *per se* a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only taxed at an unduly low rate. These weaknesses put the existing consensus-based framework at risk, and a bold move by policy makers is necessary to prevent worsening problems, the report continues, comforting sceptical governments by stating that these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income. The report also states that there is consensus among governments that moving to a system of formulary apportionment of profits[138] is not a viable way forward.

The program comprises 15 actions that are briefly reviewed below.[139]

ACTION 1: Address the tax challenges of the digital economy. The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. The internet in particular has increased the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation there due to the lack of nexus under current international rules. This raises fundamental questions as to how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes.

ACTION 2: Neutralise the effects of hybrid mismatch arrangements:[140] The report recognises that BEPS issues may arise directly from the existence of loopholes, as well as gaps, frictions or

[137] OECD (2013): Action Plan on Base Erosion and Profit Shifting http://www.oecd.org/tax/beps-reports.htm

[138] 'Formulary appointment' exists in a national context, e.g. in Switzerland, where corporate earnings are split among subnational entities according to the labour force per canton (or similar criteria), granting the canton where the company has its seat a higher share.

[139] The overlap among the actions proposed is considerable and makes the writing of a summary arduous.

[140] According to an OECD report released March 2012, hybrid mismatch arrangements generally use one or more of the following underlying elements: • Hybrid entities: Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country. • Dual residence entities: Entities that are resident in two different countries for tax purposes. • Hybrid instruments: Instruments which are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country. • Hybrid transfers: Arrangements that are treated as transfer of ownership of an asset for one country's tax purposes but not for tax purposes of another country, which generally sees a collateralised loan.

mismatches in the interaction of countries' domestic tax laws. By so-called 'hybrid mismatch arrangements', such a mismatch can be used to achieve unintended double non-taxation or long-term tax deferral by, for instance, creating two deductions for one borrowing, generating deductions without corresponding income inclusions, or misusing foreign tax credit and participation exemption regimes.

ACTION 3: Strengthen controlled foreign company (CFC) rules: One of the sources of BEPS concerns is the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate. The suggestion is to review the conditions when the criterion that a company is resident in a foreign country is fulfilled, in the sense that decisions are taken there and not only instructions from headquarters are transmitted further on. The review could result in recommendations regarding the design of controlled foreign company rules.

ACTION 4: Limit base erosion via interest deductions and other financial payments: The deductibility of interest expense can give rise to double non-taxation in both the inbound and outbound investment scenarios, the group as a whole may have little or no external debt.

ACTION 5: Counter harmful tax practices more effectively: Harmful tax practices often consist in creating preferential regimes for certain forms of companies. The report suggests compulsory spontaneous exchange on rulings related to preferential regimes, and requiring substantial activity for any preferential regime.

ACTION 6: Prevent treaty abuse to prevent BEPS that results from the interactions among more than two countries: In particular, the involvement of third countries in the bilateral framework established by treaty partners puts a strain on the existing rules, most so when done via shell companies that have little or no substance in terms of office space, tangible assets and employees. Conduit companies are also a concern. Tight treaty anti-abuse clauses could help to remedy the situation.

ACTION 7: Prevent the artificial avoidance of permanent establishment (PE) status: Tax considerations have led enterprises to replace arrangements under which the local subsidiary traditionally acted as a distributor by "commissionnaire arrangements" with a resulting shift of profits out of the country where the sales take place without a substantive change in the functions performed in that country. The action would consist in developing changes to the definition of a permanent establishment, addressing the use of commissionaire arrangements and specific activity exemptions.

ACTIONS 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation. In the area of transfer pricing, the rules should be improved in order to put more emphasis on value creation in highly integrated groups, tackling the use of intangibles, risks, capital and other high-risk transactions to shift profits.

ACTION 8: Develop rules to prevent BEPS by moving intangibles among group members. This BEPS case most often results from transfers of intangibles and other mobile assets for less than full value, the over-capitalisation of lowly taxed group companies and from contractual allocations of risk to low-tax environments in transactions that would be unlikely to occur between unrelated parties. To amend the situation, profits associated with the transfer and use of intangibles should be appropriately allocated, namely in accordance with (rather than divorced from) value creation.

ACTION 9: Analyse risk premiums and financial capital provisioning in order to better align returns with value creation: A company may use debt to finance the production of exempt or deferred income. In support of the work on interest deductions (see action 4) guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements.

ACTION 10: Consider other high-risk transactions to assure that transfer pricing outcomes are in line with value creation: The focus here is on management fees and head office expenses.

ACTION 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it: Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. Methodologically, both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns) enter into consideration.

ACTION 12: Require taxpayers to disclose their aggressive tax planning arrangements: The design of mandatory disclosure rules for aggressive or abusive transactions. Is this the obligation to auto-denunciation upon suspicion?

ACTION 13: Re-examine transfer pricing documentation: MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.

ACTION 14: Make dispute resolution mechanisms more effective: Consider, e.g., the situations addressed by action 2 (hybrid mismatch arrangements). In such situations, at the outset the question remains open regarding the jurisdiction that has to give in. The absence of arbitration provisions in most treaties makes it also difficult to clear such situations later.

ACTION 15: Develop a multilateral instrument: Changes to the OECD Model Tax Convention are not directly effective without amendments to bilateral tax treaties. If undertaken on a purely treaty-by-treaty basis, the sheer number of treaties in effect may make such a process very lengthy, the more so where countries embark on comprehensive renegotiations of their bilateral tax treaties. A multilateral instrument to amend bilateral treaties is a promising way forward in this respect.

The fear from the point of view of smaller economies is that the large nations who favour action along these lines will in the end not be ready to adopt these standards when their own rules and practices are under discussion.

Chapter 6

Accession to the WTO, Anti-dumping and Safeguard Provisions and the Agreement on Trade Related Investment Measures (TRIMs)

1 Incorporating former centrally planned economies into world trade

2 More on disciplines within WTO law – Anti-dumping provisions

3 Recurring to safeguards: The U.S.-China Tire Case

4 The Agreement on Trade Related Investments Measures (TRIM)

After having taken up – in a broad sense- Investment Protection Agreements, Free Trade Agreements and Double Taxation Agreements in the preceding three chapters, we now return to present provisions within the Marrakesh Agreement setting up the WTO.

1 Incorporating former Centrally Planned Economies into world trade

A major feature of the second wave of globalisation in the late 20th century was the integration of formerly centrally planned economies in the world trade regime as set up in 1995 by the constitution of the WTO. Looking at China and Russia, the two leading centrally planned economies, we can observe that after long discussions under the GATT, the negotiations with China came relatively quickly to a term whereas negotiations with the Russian Federation lasted up until 2012. Since its start in 1995 with 128 members, 34 countries joined the WTO, bringing the number to 162 on 30 November 2015. Still, a number of countries of some importance remain outside the WTO.[141] Here, we concentrate on China's accession to the WTO.

In a communication dated 7 December 1995, the Government of China applied for accession to the Marrakesh Agreement Establishing the World Trade Organisation ("WTO Agreement") pursuant to Article XII of the WTO Agreement. Accordingly, the Chinese government claimed that a nation-wide unified and open market system had been developed. It was also said that an improved macroeconomic regulatory system had been put in place, using indirect means and market forces to play a central role in economic management and the allocation of resources. The representative of China stated furthermore that although important achievements had been made in its economic development, China was still a developing country and therefore should have the right to enjoy all the differential and more favourable treatment accorded to developing country Members pursuant to the WTO Agreement.

In response, member countries raised numerous reservations. Examples are concerns over practices in relation to the pricing and procurement of goods and services and the distribution of import and export licences. Other members raised specific concerns regarding the authority of sub-national governments in the areas of fiscal, financial and budgetary activities, specifically with respect to subsidies, taxation, trade policy and other issues covered by the WTO Agreement and the Draft Accession Protocol. They also questioned whether the central government could effectively ensure the respect of WTO disciplines by subnational entities. Addressing these concerns, the representative of China confirmed that within three years after accession, all enterprises in China would be granted the right to trade. Foreign-invested enterprises would not be required to establish in a particular form or as a separate entity to engage in importing and exporting nor would new business licences encompassing distribution be required to engage in importing and exporting.

After these preliminaries over whether or not China could become WTO member – a question not free of geo-strategic considerations -, the negotiations themselves started. On the one hand, a working party was established; it essentially examined whether there was sufficient presence of market mechanisms within China so that the country could integrate without too many frictions into world trade. On the other hand, bilateral negotiations took place; they regarded essentially China's tariffs scheme and proceeded as in negotiating rounds. China had to bind tariff rates at or below the level of those practised in order to

[141] The WTO lists 23 countries with observer status. In principle, observers must start accession negotiations within five years after becoming observers. An observer status hold Afghanistan, Algeria, Andorra, Azerbaijan, Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Comoros, Equatorial Guinea, Ethiopia, Vatican, Iran, Iraq, Lebanese Republic, Liberia, Libya, Sao Tomé and Principe, Serbia, Sudan, Syria, Uzbekistan.

obtain support for its accession by those countries which were already members. We concentrate here on the findings of the working party. The scope of the examination which had taken place is impressive.

The report of the working party looked first at the economic policy of China in general. Issues considered were: China's readiness to accord non-discrimination (including national treatment), its monetary and fiscal policy, the foreign exchange and payments regime, measures to secure the balance-of-payments equilibrium, the investment regime, State-Owned Enterprises, compulsory prices and competition policy. If not driven by market forces, trading partners would not have obtained a fair chance to participate on the Chinese market in exchange to opening their market in a mandatory way to China. Also at a general level, a next topic was the 'FRAMEWORK FOR MAKING AND ENFORCING POLICIES'. The structure and powers of the government, the authority of sub-national governments, the question of a uniform administration of the trade regime and of judicial review were addressed. The report then focused on 'POLICIES AFFECTING TRADE IN GOODS'. Under this heading, the freedom to find a trade partner was examined. This was then further detailed, first under the heading 'IMPORT REGULATION': Ordinary customs duties, other duties and charges, rules of origin, fees and charges for services rendered and the application of internal taxes to imports were examined; this was also the case with regard to tariff exemptions, tariff rate quotas and quantitative import restrictions, including prohibitions and quotas. Other, more procedural topics were import licensing, customs valuation, other customs formalities, and pre-shipment inspection. Anti-Dumping, countervailing duties, finally the safeguards were the final themes on the import side. After imports 'EXPORT REGULATIONS' were looked at. Points examined were customs tariffs, fees and charges for services rendered, the application of internal taxes to exports, export licensing and export restrictions, finally export subsidies. A next big block looked at 'INTERNAL POLICIES AFFECTING FOREIGN TRADE IN GOODS'. Topics examined under this heading were industrial policy, including subsidies, technical barriers to trade, sanitary and phytosanitary measures, trade-related investment measures, State-trading entities, Special Economic Areas and the regulation of transit. Follows an examination of sectorial policies such as agricultural policies, trade in civil aircraft, textiles. In this connection measures to be maintained against China and transitional safeguards were looked at. A next chapter was then devoted to the 'TRADE-RELATED INTELLECTUAL PROPERTY REGIME' in general: Responsible agencies for policy formulation and implementation are named and the participation in international intellectual property agreements enumerated before requirements on undisclosed information, including trade secrets and test data and enforcement were examined. A next step was the examination of the 'SUBSTANTIVE STANDARDS OF PROTECTION', taking one category of property rights after the other: Copyright protection, trademarks, including service marks, geographical indications, including appellations of origin, industrial designs, patents and plant variety protection, finally layout designs of integrated circuits. 'POLICIES AFFECTING TRADE IN SERVICES' was the next theme. Licensing, the choice of partners, and restrictions on the modification of the equity interest were first points examined. The prior experience requirement for an establishment in the insurance sector were taken up, followed by an examination of rules applicable to inspection services, market research and legal services. Minority shareholder rights were also looked at. Government procurement was dealt with under 'OTHER ISSUES' since an access of China to the plurilateral Government Procurement Agreement was not topic of the negotiations.

To give an impression of the substance figuring under the different headings, we take up the chapter on trade related investment measures, as we will describe the TRIMs agreement further below in this chapter. With regard to TRIMs, the representative of China confirmed that upon accession, as set forth in the Draft Protocol, China would comply fully with the agreement, without recourse to Article 5 thereof, and would eliminate foreign-exchange balancing and trade balancing requirements, local content requirements and export performance requirements. Chinese authorities would no longer enforce the terms of contracts containing such requirements. The allocation, permission or rights for importation and investment would not be conditional upon performance requirements set by national or sub-national authorities, or subject to secondary conditions covering, for example, the conduct of research, the provision of offsets or other forms of industrial compensation including specified types or volumes of business opportunities, the use of local inputs or the transfer of technology. Permission to invest, import licenses, quotas and tariff rate quotas would be granted without regard to the existence of competing Chinese domestic suppliers. Consistent with its obligations under the WTO Agreement and the Draft Protocol, the freedom of contract of enterprises would be respected by China.

The Working Party took not only note of these and similar commitments. In order to give sufficient grip to the outcome of the negotiations, the report of the working party contained also one hundred pages of annex with detailed lists on relevant provisions in place on Chinese markets, e.g. in form of price controls, and whether they have to be phased out and over which period. China had also to accept that WTO member states reserved their right to protect their industries temporarily under particular provisions by special safeguard measures (see below under 4.). China's accession was finally approved on 11 December 2001.

2 More on disciplines within WTO law – Anti-dumping provisions

Binding tariffs and applying them equally to all trading partners according to the MFN-clause are key to the smooth flow of trade in goods. The WTO agreements upholds these principles, but also allows exceptions — in particular circumstances. Three of these are:

- actions taken against dumping (selling at an unfairly low price)
- subsidies and special "countervailing" duties to offset the subsidies
- emergency measures to "safeguard" domestic industries by limiting imports temporarily.

Chapter 1 provided a detailed presentation of WTO provisions in the area of agricultural subsidies (the Brazil-US-cotton dispute) and Chapter 3 brought up the issue of subsidies in the manufacturing sector (by considering special processing zones). In this chapter, we will present in some detail a case where the US invoked a safeguard clause to protect one of its industries. But before, given the importance of dumping allegations, we take up the first entry among the three, anti-dumping, mainly by reproducing some statistical tables. We start by describing the basics of anti-dumping provisions in WTO law.

The antidumping provisions in WTO law[142]

If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be "dumping" the product. Opinions differ whether this is unfair competition, but many governments take action against dumping in order to defend their domestic industries. The WTO agreement does not pass judgement. Its focus is on whether governments can or cannot react to dumping and how. The Anti-Dumping Agreement clarifies and expands Article VI of GATT allowing countries to take action against dumping.

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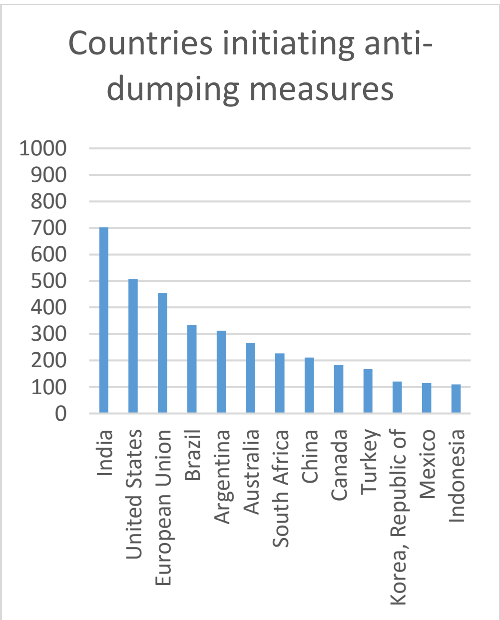
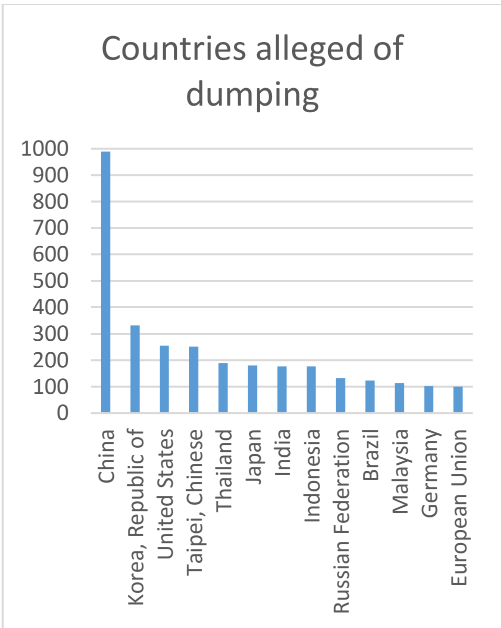
The statistics on anti-dumping measures





Not all WTO-member countries initiate but all member states can be subject to dumping allegations. Frequencies of allegations are shown by the graph above

[142] The text is from the WTO homepage. See: https://www.wto.org/english/tratop_e/adp_e/adp_e.htm

There are many different ways of calculating whether a particular product is being dumped. The main method to calculate a product's "normal value" is based on the price in the exporter's domestic market. When this cannot be used, two alternatives are available — the price charged by the exporter in another country, or a calculation based on the combination of the exporter's production costs, other expenses and normal profit margins. And the agreement also specifies how a fair comparison can be made between the export price and what would be a normal price.

If dumping is established and an additional investigation shows that the alleged case of dumping is causing "material" injury to the domestic industry, the exporting company can undertake to raise its price to an agreed level in order to avoid an anti-dumping import duty. If it refrains to do so and anti-dumping measures are taken, they must expire five years after the date of imposition, unless an investigation shows that ending the measure would lead to injury. Anti-dumping investigations are to end immediately in cases where the authorities determine that the margin of dumping is insignificantly small (defined as less than 2% of the export price of the product) or if the volume of dumped imports is negligible (i.e. if the volume from one country is less than 3% of total imports of that product).

Members are encouraged to consult each other when differences arise, they must report to the Committee on Anti-Dumping Practices on all investigations twice a year and about all preliminary and final anti-dumping actions, promptly and in detail, and they can use the WTO's dispute settlement mechanism.

3 Recurring to safeguards: The U.S.-China Tire Case[143]

Launched by a Labour Union, the U.S. International Trade Commission (ITC) initiated an investigation under Section 421 of the U.S. Trade Act of 1974 on the allegation that Chinese passenger vehicle and light truck tires were causing market disruption to U.S. tire producers. In June 2009, the ITC concluded by a 4-2 vote that imports of the subject tires were indeed causing "material" market disruption and recommended that the President imposes an additional duty on these items for three years at an annually declining rate. The ITC also recommended expedited consideration of applications for trade adjustment assistance (TAA) filed by affected firms or workers.

On September 11, 2009, President Obama proclaimed increased tariffs on Chinese tires for three years effective 26 September 2009, although at lower rates than those recommended by the ITC. The tariff increase was 35% ad valorem in the first year, 30% in the second year, and 25% in the third year. The President also directed the Secretaries of Labor and Commerce to expedite TAA applications and to provide other available economic assistance to affected workers, firms, and communities.

Section 421 was used to implement in U.S. law a China-specific safeguard mechanism in China's WTO Accession Protocol that could be utilized by WTO members through December 2013. The provision in the Protocol is separate from Article XIX of the General Agreement on Tariffs and Trade (GATT) 1994 and the WTO Agreement on Safeguards, which allow WTO members to respond to injurious import surges but on a stricter basis than under the Protocol. A major difference is that the Protocol permits a safeguard to be applied only to Chinese products while the Safeguards Agreement requires that any safeguard be applied to a product regardless of its source.

A safeguard may take the form of a tariff surcharge, which involves the suspension of a negotiated tariff concession under Article II of the GATT, or an import quota, which involves the suspension of the obligation in GATT Article XI:1 not to impose quantitative restrictions on imports from other WTO members. Another option is a tariff-rate quota (TRQ), under which a specified volume of goods may be entered under a lower tariff rate, with out-of-quota items subject to higher rates. It adds that the increased quantities of imports that are a prerequisite of a finding of serious injury may be "absolute or relative to domestic production." A safeguard is subject to detailed obligations to notify the WTO Committee on Safeguards and the WTO Council on Trade in Goods and to consult with other affected WTO members. Although the Agreement on Safeguards does not contain language requiring the existence of "unforeseen developments," the WTO Appellate Body has determined that the requirement continues to apply. The "serious injury" standard contained in Article XIX and carried forward in the Safeguards Agreement is defined in the Agreement as meaning "a significant overall impairment in the position of a domestic industry." The WTO Appellate Body has found that this standard is "on its face, very high", higher than in the case of alleged dumping, arguing that the measure is not taken on "'unfair' trade

[143] The information and much of the text in this subchapter are taken from Jeanne J. Grimmett (Legislative Attorney at the Research Service of the US Congress): Chinese Tire Imports: Section 421 Safeguards and the World Trade Organization (WTO), July 12, 2011. The valuations reflect the opinion of the author of this book, however.

actions, but on an evolution on the market in question. The Agreement also places a time limit on a safeguard measure, providing that it may not be initially applied for more than four years but eventually extended to eight years. Importantly, members imposing quantitative restrictions or quotas under the Safeguards Agreement may not "seek, take or maintain any voluntary export restraints, orderly marketing agreements or other similar measures on the export or the import side," whether such actions are taken by a single member or as actions under "agreements arrangements and understandings entered into by two or more members." Furthermore, and reflecting the fact that the exporting countries are not acting faultily, the members may agree on "any adequate means of trade compensation. However, the agreement prohibits members from exercising their right of equilibrating suspension of tariff concessions for the first three years that a safeguard measure is in effect, provided that the safeguard (1) is taken as a result of an *absolute* increase in imports and (2) is consistent with the Safeguards Agreement. [144]

Four U.S. safeguards have been successfully challenged in the WTO.[145] Among other findings, the WTO Appellate Body determined that the United States had acted inconsistently with Article XIX of the GATT or the Safeguards Agreement, as the case may be, due to inadequate or improper analysis of one or more of the following criteria: the existence of unforeseen developments, increased imports, serious injury or threat, and causation—that is, whether increased imports had caused or were causing serious injury—including issues related to non-attribution of injury to factors other than increased imports.

In the tire case, China filed a WTO complaint against the United States in September 2009, claiming that the Section 421 tariffs violate U.S. GATT obligations to accord Chinese tires MFN tariff treatment and not to exceed negotiated tariff rates, that the United States imposed tariffs under the Protocol safeguard mechanism without first attempting to justify them under GATT and WTO safeguard provisions, and that Section 421 and its application in this case violate U.S. obligations under the Protocol. In a report issued 13 December 2010, the WTO panel rejected all of China's claims. China appealed the report on 24 May 2010, arguing that the panel misinterpreted and misapplied certain standards in the Protocol as they relate to the ITC determination, but the Appellate Body upheld the decision.

To understand the ruling, it is important to be aware of the differences between safeguards based on the Agreement and those based on China's accession protocol. First and foremost, the protocol requires "material injury", a standard considered less onerous than the "serious injury" standard contained in the Article XIX of the GATT and the Agreement on Safeguards. Secondly, it is questionable whether the market evolution must be "unforeseen", as the measure can only be taken in a limited period after a known event, WTO-accession. A third distinction is that China might have taken such action as to prevent or remedy the market disruption, e.g. entered a voluntary export restraint agreement with the US, a measure made possible by the bilateral nature of the litigation; in fact, the safeguard was only applied to goods of Chinese origin.

The ruling of the panel is largely based on formal criteria. It refrained from establishing own economic criteria – irrespective of the case - on the point when the level of a "material injury" is reached. Rather, in determining whether market disruption exists, the panel checked how the importing member proceeded. The question was whether it looked at "objective factors," including import volume, the effect of imports on prices for like or directly competitive articles, and the effect of the imports on the domestic industry producing such articles. The panel thus attached considerable weight on how the U.S. authority approached the case and judged this proceeding as sufficient.

In its decision, the ITC had first determined that the period of investigation for the Section 421 proceeding was 2004-2008. It then found that the imports of the subject tires were increasing rapidly in both relative and absolute terms during this period, summarizing its conclusions as follows: In absolute terms, imports of the subject tires from China increased throughout the period of investigation and were the highest, in terms of both quantity and value, in 2008, at the end of the period. The quantity of subject imports rose by 215.5 percent between 2004 and 2008, by 53.7 percent between 2006 and 2007, and by 10.8 percent between 2007 and 2008. The value of subject imports rose even more rapidly, increasing by 294.5 percent between 2004 and 2008, by

[144] In the past, while some affected WTO members have claimed that the three-year limitation did not apply based on unilateral assessments of WTO-consistency, a majority has waited in this period until adverse panel and Appellate Body reports were adopted by the WTO Dispute Settlement Body.

[145] Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia, Wheat Gluten from the European Communities, Welded Pipes from Korea, Certain Steel Products (EU, Switzerland and other countries).

60.2 percent between 2006 and 2007, and by 19.8 percent between 2007 and 2008. Both the ratio of subject imports to U.S. production and the ratio of subject imports to U.S. apparent consumption rose throughout the period examined, and both ratios were at their highest levels of the period in 2008. The ratio of subject imports to U.S. production increased by 22.0 percentage points between 2004 and 2008, with the two largest year-to-year increases occurring at the end of the period in 2007 and 2008. The ratio of subject imports to U.S. apparent consumption increased by 12.0 percentage points during the period examined, with the two largest year-to-year increases also occurring at the end of the period in 2007 and 2008.

The domestic injury on the sector producing passenger vehicle and light truck tires was established along the following lines: First, the ITC found the sector to consist of ten U.S. producers “ranging from large multinational companies with global production and sales and varying levels of vertical integration to smaller producers with only domestic operations.” The ITC then found that in 2008, “U.S. producers manufactured such tires in 28 plants, with most of these plants producing the tires with dedicated equipment, machinery, and workers.” Finally, the ITC argued that four plants were closed during the period examined, and in light of the current conditions, U.S. producers had announced plans to close three more plants in 2009.

In a third step, the ITC then found that “there is a direct and significant connection between the rapidly increasing imports of subject tires from China and the domestic tire industry’s deteriorating financial performance and declining capacity, production, shipments, and employment,” The ITC rejected a view according to which the closures were part of a strategy by domestic tire producers to voluntarily abandon the low-priced segment of the U.S. market so that imports from China did not act as the trigger.

Whilst the ITC proposed a three-year duty increase, declining from 55% *ad valorem* in the first year, to 45% *ad valorem* in the second year, and 35% *ad valorem* in the final year the President reduced these rates to 35%. 30% and 25%.

Elements allowing a critical assessment of this decision are provided by the arguments advanced by the two dissenting ITC commissioners. They suggested that a “trade-restricting remedy would not provide relief to the domestic industry and respectfully urged the President to focus on providing economic adjustment assistance to displaced tire workers through continued use of Trade Adjustment Assistance or other programs that might be available to suppliers of the battered U.S. automobile industry.” If a trade measure were to be chosen, they suggested that it be a tariff-rate quota with a quota of 41.5 million tires and an over quota rate of 55% in the first year, 45% in the second year, and 35% in the third year. The commissioners stated that this approach “avoids a large increase in the base cost of the tires purchased by the poorest customers, and provides greater stability in pricing in the U.S. market.”

Indeed, to impose higher tariffs is an appropriate measure in litigations where the other party acted faultily. For an economist, a safeguard measure should not be inspired by the tit for tat in such a conflictual situation, however, but open a window of opportunity in which redress can be achieved by domestic reforms. At best, the extra tariff revenue generated by the measure here considered financed the trade adjustment assistance, but for the rest, the measure taxed prospering Chinese tire manufactures and hurt U.S. customers; there is no indication that thanks to the measure plants were reopened. Note that a voluntary export restraint agreement negotiated with the Chinese would have left the rent stemming from smaller quantities and correspondingly higher U.S. prices with the Chinese manufacturers while the quota system would most likely have been to the benefit of the U.S. importers to whom the quota would have been allocated, competition among them eventually obliging them to pass the advantage on to final customers, as the two dissenting commissioners hoped for. On the other hand, the panel deserves some credit when it emphasizes that its task was to interpret the China-specific safeguard and “not to seek to recalibrate what the WTO members had agreed to”, i.e.it was not entitled to examine alternatives. How tenuous the panel’s ruling is appears through the sentence that “the decision to locate production in China might have been the result of an independent business strategy, but the decision to close plants might well have been a response to imports”.

4 The Agreement on Trade Related Investments Measures (TRIM) [146]

Perhaps the most significant development with respect to investment in the period before the Uruguay round was a ruling by a panel in a dispute settlement proceeding between the United States and Canada. Canada required for the approval of investment projects from foreign

[146] The following text (except the final remark) is from the WTO’s homepage. See https://www.wto.org/english/tratop_e/invest_e/invest_info_e.htm

investors that their undertakings pertained to the purchase of certain products from domestic sources (local content requirements) and to the export of a certain amount or percentage of output (export performance requirements). The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT but that the export performance requirements were not inconsistent with GATT obligations. The Panel's decision made clear that Canada's right to regulate foreign investment *per se* did not fall under the scrutiny of the GATT but only trade effects such legislation might have. The panel's conclusion that export performance requirements were not covered by the GATT underscored the limited scope of existing GATT disciplines with respect to FDI.

The Uruguay Round negotiations on trade-related investment measures were marked by strong disagreement among participants over the coverage and nature of possible new disciplines. While some developed countries proposed provisions that would prohibit a wide range of measures in addition to the local content requirements found to be inconsistent with Article III in the reported panel case, many developing countries opposed this. The compromise that eventually emerged from the negotiations is essentially limited to an interpretation and clarification of the application to trade-related investment measures of GATT provisions on national treatment for imported goods (Article III) and on quantitative restrictions on imports or exports (Article XI). Thus, the TRIMs Agreement does not cover many of the measures that were discussed in the Uruguay Round negotiations, such as export performance and transfer of technology requirements. Furthermore, the TRIMs Agreement does not apply to services.

An 'Illustrative List' annexed to the TRIMs Agreement enumerates measures that are inconsistent with paragraph 4 of Article III and paragraph 1 of Article XI. Assimilated to domestic content prescriptions is for example an obligation that exports have to match imports (trade balancing, also payments balancing). Exceptions under the GATT agreement extend to the TRIPS agreement. For the rest, the agreement stipulates notification obligations, sets up a supervisory committee and provided transitional provisions.

Some export performance and transfer of technology requirements may however fall under the Agreement on Subsidies (promotional measures for FDI granted in export processing zones) and the TRIPs agreement (keyword compulsory licencing). Furthermore, the GATS is of relevance for FDI in services (in particular mode 3). If the obligations of WTO members under GATS include e.g. the right to establish a commercial presence this is helpful also for manufacturing companies.

As framework conditions for FDI, the TRIMs Agreement presumably has only subordinated importance, other WTO agreements and in particular bilateral investment protection agreements and investment chapters in preferential trade agreements appear as more relevant.

Chapter 7

Education and Health: The Legal Framework for Two Forthcoming Areas of Globalisation

The present chapter will present the General Agreement on Trade in Services, GATS. This agreement became one of the cornerstones of the WTO system in 1995. This agreement is not only very comprehensive, it serves also as the basis for chapters on the provisioning of services in regional agreements. In order to understand the agreement, the four modes of provisioning services distinguished under the GATS agreement need to be known. We will present these four modes by way of concentrating on a specific sector, namely education. This allows us to consider also within this chapter the question of diploma recognition in the general context of the free movement of labour, particularly in Europe. The chapter concludes with pointing to standardisation processes under way in the area of educational content. The latter not only facilitate a continuation of studies by moving from one country to the other. Standardisation is also helpful with regard to diploma recognition in protected professions. Diploma recognition has not only a bearing on labour mobility but also on the free flow of goods and services.

1 Swiss commitments under the GATS regarding education

Within the negotiations leading to the Marrakesh Agreement, Switzerland, as all the other WTO members, had to lay down a comprehensive list of commitments with regard to the provisioning of services. On the one hand the countries had to make horizontal commitments, applicable to all categories of services distinguished. On the other hand, they made sector specific commitments. The catalogue of service categories distinguished came from the United Nation's Central Product Classification

As indicated in the introduction, a very important aspect of GATS is that four modes of providing a service are distinguished, namely:

- GATS mode 1, the cross border provision of a service. Here the service itself crosses the border. Long limited to transportation, GATS mode 1 has gained in importance due to the extension of services that can be rendered based on electronic interconnections. It is no longer an obstacle to attend classes by way of the internet, interaction with the teacher also being possible. Awareness with regard to what GATS Mode 1 will cover in today's electronic environment has still to grow.
- Traditionally it was thought that either the provider of the service has to cross the border (GATS Mode 4) or the customer (GATS Mode 2) to resp. deliver or receive the service.
- In order to secure the permanent provisioning of services, companies will often decide to create a local establishment. Provisioning by a local establishment is GATS Mode 3.

Teaching offered to foreigners in Swiss schools falls under GATS Mode 2 (the customer crosses the border). To restrict access of customers to a domestic offer is rather uncommon given that a mercantilist spirit prevails in trade. This attitude changes once the domestic provisioning of services is heavily subsidized or for free as this is the case in Switzerland with regard to compulsory schooling. Also, with respect to compulsory schooling, defined educational targets are set even at the constitutional level and in elaborate legislation mainly at the sub-federal level, and these targets should not be endangered by the cross-border provisioning of such schooling. The following table brings this out.

The table below shows the specific commitments of Switzerland in the area of 'educational services', the latter being subdivided in compulsory primary education and secondary education I, non-compulsory secondary education II, higher education and adult education. Secondly, a distinction is made between market access and limitations of national treatment. In each of these columns, the commitments with regard to the four modes of service provisioning are then detailed. Given the defined targets, compulsory schooling has to achieve, Switzerland preferred not to submit the choice of private providers in compulsory education to the GATS disciplines unless the provider has a foothold in Switzerland in the form of an establishment (entry "unbound" for modes 1,2 and 4). For private schools providing compulsory schooling locally, cantons have specific legislations and a surveillance system, so that Switzerland submitted these offers when provided on a private basis to the GATS rules.

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Sector Specific Commitments of Switzerland

Export selected member specific commitments to
See also the Horizontal Commitments

Mode of Supply : 1) Cross-border supply 2) Consumption Abroad 3) Commercial presence 4) Presence of natural persons

Sector / Sub-sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments	Notes
05. Educational Services				
Private Educational Services: - Compulsory education services (primary & secondary I)	1) Unbound	1) Unbound		
	2) Unbound	2) Unbound		
	3) None	3) None		
	4) Unbound	4) Unbound		
- Non-compulsory secondary education services (secondary II)	1) None	1) None		
	2) None	2) None		
	3) None	3) None		
	4) Unbound except as indicated in Part I	4) Unbound except as indicated in Part I		
- Higher Education Services (CPC 923)	1) None	1) None		
	2) None	2) None		
	3) None	3) None		
	4) Unbound except as indicated in Part I	4) Unbound except as indicated in Part I		
- Adult Education Services (CPC 924)	1) None	1) None		
	2) None	2) None		
	3) None	3) None		
	4) Unbound except as indicated in Part I	4) Unbound except as indicated in Part I		

The “none” in line (3), meaning no restrictions, with regard to the establishment of foreign schools offering training at the level of primary schools and lower secondary schools needs to be understood with considerable reservations once one looks at economic incentives. While parents living within Switzerland are under some provisions regarding the content and the quality of the offer free to send their children to private schools, it holds true for private primary schools independently whether they are run by Swiss persons or foreigners that they cannot claim a subsidisation comparable to what pupils would cost in the government run compulsory school system. This comparative advantage for public offers extends to private providers of education in higher levels of schooling and – to a considerable degree - in the professions as well.

Outside the range of compulsory schooling, Switzerland only refrained from commitments with respect to services rendered by persons coming into Switzerland as teachers (GATS mode 4, i.e. the person rendering the service crosses the border). With regard to their admission, Switzerland remains free, under one reservation. This reservation is reflected on the one hand by the parenthesis “except as indicated in Part I” on the corresponding line, but also by the remark at the top of the table “See also the Horizontal Commitments”. In fact, it needs to be emphasised that sectorial commitments as the one’s shown here with regard to education have to be read in conjunction with the commitments the countries have engaged in according to part I of the GATS agreement where restrictions pertaining to all sectors are listed. Access to the Swiss labour market is heavily restricted. So, even if a private provider is allowed to set up a private school in Switzerland, this does not mean that he can carry along with him the teachers. The eligibility of foreign teachers will be decided separately, based on their personal qualifications, the working conditions offered by the school and in addition admission may be subject to a quota. When a foreigner sets up an establishment in Switzerland, he is only entitled to bring along the key personnel needed to run the establishment. Applied to schools this means that as principal of the school the owner of a private school can presumably claim a permit of sojourn.

An aspect that is not made explicit in the table but is relevant with regard to the attendance of private schools in Switzerland by foreigners (or moving in as the principal of a private school) are the general conditions limiting the right to stay in Switzerland. The GATS commitments do not supersede visa requirements, and a general "police"-clause holds (expulsion after having committed a crime is possible). Also, the person attending classes in Switzerland has to cover her living costs by her own means. She is neither entitled to obtain social benefits to cover her living costs nor to scholarships in order to pay for tuition.

A question arising is whether a foreigner can be charged as an incoming foreign student a different price. The question is relevant when the schooling is free for Swiss people or when the schooling is offered or heavily sponsored by a public entity. The principle of national treatment extends to GATS mode 2. In a communication to the Council of Trade in Services dated 4thApril 2005 (WTO TN/S/W/39), Switzerland has explained its understanding of its commitments. First, it is said that accreditation, funding, acknowledgment as a public institution or as a public service are to be considered separately. Subsequently, it is acknowledged that in accordance with the specific commitments undertaken, national treatment applies also in relation to certain educational services provided by a public education institution. The three criteria making an educational service a public one – the case *not* covered by the example quoted below, but relevant e.g. with regard to disciplines affecting the subsidising of educational offers - are that the title or curriculum are approved by government or a service charged by government with accreditation responsibilities, that a legal act makes clear that the service offered is part of the general education system, and that a "needs"-clause is fulfilled in the sense that public action to provide such a service would be required if it did not already exist in order to achieve public educational goals. Then the following example is given: A public institution may be accredited, it may or may not receive public funding for the educational service under examination and it may deliver *private* higher education services (part of CPC 923) since the three criteria presented above are not fulfilled. Then, national treatment shall not apply.

This is a very contorted reasoning and to answer the question raised at the outset of the paragraph turns out to be tricky. In this regard, it is of some relevance that the GATS is only binding the nations and that national courts are reluctant in applying Swiss GATS commitments directly when a foreign person brings a case to a Swiss court.

Different to education, Switzerland has not made any commitments with regard to health services. One aspect behind this decision is that in exchange for its commitments Switzerland would have obtained only very limited market access in major trading partners. Particularly in Europe, i.e. in Switzerland's neighbouring countries, health services are essentially provided by the public sector. Governmental services are explicitly carved out of the GATS agreement, however, and there is nothing in GATS that forces a government to privatize service industries.[147] The carve-out is an explicit commitment by WTO governments to allow publicly funded services in core areas of their responsibility. Governmental services are defined in the agreement as those that are not supplied commercially and do not compete with other suppliers. These services are not subject to any GATS disciplines, they are not covered by the negotiations, and commitments on market access and national treatment (treating foreign and domestic companies equally) do not apply to them. The other aspect leading to the decision not to make commitments in health services is that across Switzerland, health services are provided by public, non-for-profit and for profit units in a very heterogeneous manner. Economic freedom is also not applicable since the government can decide e.g. which hospitals in a region are service providers entitled to treat patients covered by the compulsory health insurance system. Within this system, health insurers have to cover costs according to a comprehensive catalogue of treatments for basic health risks but they may also offer enhanced services based on a private insurance contract. As an illustrative example for the working of the system, one may e.g. mention that patients were for a long time restricted in the choice of their hospital as long as they did not acquire complementary private health insurance granting a free choice of the hospital. Evidently, it would have been very complicated to fit this system into the defined framework for commitments under GATS, thereby also allowing a future evolution of institutions in the health sector.

As evidenced by the case of health services, GATS' approach to making commitments means that members are not obliged to do so on the

[147] This paragraph is built on quotes from https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm

whole universe of services sectors. If a government does not want to make a commitment on the level of foreign competition in a given sector, the government's only obligations are minimal, for example to be transparent in regulating the sector, and not to discriminate between foreign suppliers.

The negotiated schedules of commitments under GATS are an important starting point for negotiations of second generation free trade agreements which include also a chapter on services. The ambition of these chapters is uneven from one treaty to the next. Often, a 'positive list' approach is chosen, i.e. commitments in additional sectors are exchanged on a bilateral basis. NAFTA has chosen a 'negative list' approach, i.e. sectors where market access for service providers from the partner countries is restricted have to be explicitly named. NAFTA's approach is the reason why also the FTA between Mexico and EFTA member countries is based on a negative list approach. However, the spelling out of the negative list extended well beyond the conclusion of the agreement in the year 2000.

2 The framework for diploma recognition in Europe[148]

Having seen that commitments under the GATS are limited and, specifically, that they can hardly be invoked by individual persons, it becomes evident that the free movement of persons within the EU could not build on this framework, also because it was only adopted in 1995. The EU had to develop own rules in order to secure the free movement of persons among member states. Factually, the free movement of persons is inhibited to a point that the freedom can no longer effectively be exercised when all the training up to a diploma has to be repeated in the host country in order to get market access there. And throughout EU member states, market access depends in a (varying) series of professions on proven specific qualifications. It needs also emphasising that diploma recognition is not only relevant for exercising the free movement of persons, but also for the free movement of goods and services since safety requirements tend to require that a person with a certified education establishes necessary attestations.

An essential ruling regarding diploma recognition[149] is the Judgment of the EU Court of 7 May 1991 opposing Irène Vlassopoulou and Baden-Württemberg where the German Bundesgerichtshof had asked for a preliminary ruling (Case C-340/89). Besides her Greek diplomas, Mrs Vlassopoulou had a doctorate in law from the University of Tübingen (Germany). Since July 1983 she had been working in a cabinet of German lawyers at Mannheim and in November 1984 she received permission to deal with foreign legal affairs concerning Greek law and Community law, in accordance with the German Law on legal advice. As far as German law is concerned, Mrs Vlassopoulou practised under the responsibility of one of her German colleagues in the firm. When she applied for direct admission as a lawyer, the Ministry refused her application on the ground that she did not have the formal qualifications for the admission to the profession of lawyer and that she would need to complete classes at a German university, pass the First State Examination, complete a preparatory training period and then pass the Second State Examination. The EC Court stated that Article 52 of the EEC Treaty must be interpreted as requiring the national authorities of a Member State to which an application for admission to the profession of lawyer is made by a Community subject who is already admitted to practise as a lawyer in his country of origin and who practises as a legal adviser in the first-mentioned Member State to examine to what extent the knowledge and qualifications attested by the diploma obtained by the person concerned in his country of origin correspond to those required by the rules of the host State; if those diplomas correspond only partially, the national authorities in question are entitled to require the person concerned to prove that she has acquired the knowledge and qualifications which are lacking.

Based on this and similar rulings, the EU had to complete its system of diploma recognition. Beforehand, the EU had embarked on a process where for single professions professional requirements were laid down in an EU-directive before the universities in each member state handing out diploma satisfying these requirements were enumerated. Parallel to this harmonisation procedure, of which beyond different categories of engineers and medical doctors also nurses benefitted, a complementary procedure of mutual recognition had to be established. National authorities in charge of admitting foreign professionals to a domestic market where diploma requirements apply have now to examine the equivalence of the training undergone in the home state and required domestically; in case of divergence, the candidate must be given either the possibility to pass a complementary exam or to acquire the lacking professional qualifications by a 'stage' in the host country.

[148] http://ec.europa.eu/internal_market/qualifications/directive_in_practice/general_system/index_en.htm

[149] http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:61989CJ0340&from=FR

Since Switzerland has an agreement on the free movement of persons with the EU, the directives and rulings in the EU with regard to diploma recognition apply also in Switzerland.[150] The authorities tend to apply these criteria also with regard to persons who have completed their education outside of the EU.

Student mobility within EU/EFTA

Usually on their own initiative, students show an interest to change university even before completing a degree. With the idea to achieve comparability of education at the University level, the Bologna Process of the EU sat a milestone.[151] It allows to count the credits obtained in one university against the required credit points in the university where the student seeks to continue studies and to obtain a formal degree. With respect to professional qualifications, the Copenhagen Process[152] aims to achieve a similar mobility. The Bologna Process required substantial reform of the curricula in higher education (including the health professions) throughout the EU/EFTA states.

Similar efforts on the global scale are limited to specific areas. One is university access, to which we turn in the next section. An alternative are bilateral agreements. Switzerland, e.g., has concluded trainee exchange agreements with various countries (namely Argentina, Australia, Bulgaria, Canada, Chile, Japan, Monaco, New Zealand, Philippines, Romania, Russia, South Africa, Tunisia, Ukraine, USA) in order to enable young professionals to extend their occupational and linguistic skills in Switzerland. Work permits can be granted for a maximum of 18 months and are limited in number. In connection with such agreements, several countries have addressed questions of diploma equivalence.

3 Obtaining access to university at the global level

Schools interested in attracting students from foreign countries have an eminent interest that the final certificates they hand out allow their students to enter quasi every university in the world, provided they pass the exams at the school with the necessary credits. The International Baccalaureate which we will describe in more detail below has become a global standard for the training future students have to complete to gain worldwide university admission.

The relevance of the International Baccalaureate becomes evident by looking at the requirements for admission the Conference of the Directors of Swiss Universities laid down. According to their decision, the needed document, a foreign upper secondary school-leaving certificate, must correspond substantially to the Swiss Maturity Certificate with regard to subjects of schooling, the number of hours, and the length of schooling. Specifically it must be the highest possible upper secondary school-leaving certificate in the issuing country, it must entitle the holder to general access to university studies, it must - as a rule - be attained in an unabridged course of schooling in a school class, it must be in one of the following streams: classical languages, modern languages, humanities and social sciences, or mathematics and natural sciences, and it must qualify as general education. It is with regard to the last criterion that the standard setting that occurred with the International Baccalaureate becomes evident. Foreign school-leaving certificates are considered to be general education if the last three years of schooling include at least six general education subjects, independent of one another, in accordance with the following list:

1. First language (native language)
2. Second language
3. Mathematics
4. Natural sciences (biology, chemistry or physics)
5. Humanities and social sciences (geography, history or economics/law)
6. Elective (one additional subject from either category 2, 4 or 5).

In fact, this canon of topics matches the requirements established by the organisation that administers the granting of the International Baccalaureate.

The International Baccalaureate (IB)

As an organisation, the International Baccalaureate® (IB) was founded in Geneva, Switzerland, in 1968 as a non-profit educational foundation. A group of forward-thinking teachers at the International School of Geneva, with assistance from several other international schools, created the IB Diploma Programme. Today, the organization is divided into three regional centres: IB Africa, Europe and Middle East (IBAEM), administered

[150] The integration of new directives and rulings in Swiss law is non-dynamic. Periodically, the EU and Switzerland have to establish by a formal act that Swiss law is again aligned to the state of EU legislation.

[151] For more information see http://ec.europa.eu/education/policy/higher-education/bologna-process_en.htm

[152] See e.g. http://www.bmbf.de/en/3322.php

from The Hague; IB Americas (IBA), administered from Bethesda and Buenos Aires, Argentina; and IB Asia-Pacific (IBAP), administered from Singapore. It has consultative status as a non-governmental organization (NGO) at United Nations Educational, Scientific and Cultural Organization (UNESCO) and has collaborative relationships with the Council of Europe and the Organisation Internationale de la Francophonie (OIF). There are more than 1'190'000 IB students at 3'806 schools in 147 countries.

A student has to choose within in each of the six topical groups one subject, and regarding three of these he then has to attend a class at the higher level, in the three remaining at the standard level. For a class at the higher level, the suggested number of lessons is 240, for a class at the standard level 150 lessons. In addition, a student has to attend an instruction on the Theory of Knowledge (ToK). Furthermore, an Extended Essay (EE) of 4000 words has to be prepared on a scientific topic the student is free to choose. The latter forms also part of the assessment as his attendance in the Creativity, Action and Service Programme (CAS) which takes place outside of the school. Students can study and take examinations in English, French or Spanish. The written examinations at the end of the programme are marked by external IB examiners. Students also complete assessment tasks in the school, which are either initially marked by teachers and then moderated by external moderators or sent directly to external examiners.

To obtain within Switzerland the International Baccalaureate is primarily made possible by the numerous international schools established by private initiative and mainly on the shores of the Lake of Geneva (remember the place of origin of the IB). To them, making the investment to become an IB World School is essential although accreditation is an intensive process that typically takes two or more years and includes site visits by an IB team. Interestingly, a number of upper-secondary schools preparing for University (Gymnasium) and run by the cantons have also recognised the value of handing out a final attestation that is routinely accepted as entry pass to universities in the world.[153] On the list figure the Literatur- and Real-Gymnasium Rämibühl in Zurich and the Gymnasium am Münsterplatz in Basel. By offering this option, they show a remarkable customer orientation, although we will leave the question open whether they consider their students or the international companies located in these important cities as their clients. Normally, the conviction that national curricula are the most suited, the public financing and inertia among the teachers should have retained change.[154]

More on initiatives to achieve comparability of education on a global scale

The international baccalaureate was conceived as an instrument allowing diplomats and other expats to swiftly change from the secondment to one country to the sending towards a next country even when their children are at the age of schooling. This need extends beyond the upper secondary level, so that the international baccalaureate organisation proposes three additional programmes, one for children at the age of 3 to 12, one for children in a middle age (11-16) and, for the same age group as the diploma programme (i.e. 16-19), a career related certificate (named IBCC). The latter is made up of at least two Diploma Programme courses, an IBCC core that includes approaches to learning, community and service, language development plus a reflective project, and an approved career-related study.

[153] The Swiss Matura requires a larger number of topics taught, but within the single subjects the requirements are usually not as far reaching as this is the case with the International Baccalaureate.

[154] The slow introduction of imbrication as a teaching technique in Switzerland is telling in this regard. Despite the disappointing success of traditional langue teaching and the success in Canada of the method, the idea that students and the national community are best served when some subjects are taught in the other language of the country progresses only slowly. The Canadian experience is not without interest for mitigating the social tensions arising from cultural cleavages within countries and globalisation in general.

Chapter 8

Concessionary Regimes and Public Procurement Legislation

1 The legal framework for Government Procurement

2 The plurilateral agreement on Government Procurement

3 The Public Procurement Chapter in the Colombia-EFTA-FTA

1 The WTO Framework for Government Procurement

Government procurement is of considerable economic significance, accounting for a significant proportion of national GDP. At the domestic level, the parsimonious use of public funds, transparency, competition and equal treatment constitute essential requirements of an efficient government procurement system. As public procurement of goods and services represents a major part of a country's market for foreign suppliers, government procurement is also of great importance to international trade flows. Nonetheless, in the General Agreement on Tariffs and Trade, originally negotiated in 1947, government procurement was explicitly excluded from the key national treatment obligation. More recently, government procurement has also been excluded from the main market access commitments of the General Agreement on Trade in Services.

Over the years, GATT and WTO Members have therefore been seeking other ways to address the issue of government procurement in the multilateral trading system. This has resulted in three main areas of work within the WTO: [155]

(a) the plurilateral Government Procurement Agreement (the so-called “GPA”);

(b) negotiations on government procurement in services pursuant to Article XIII:2 of GATS;

(c) the work on transparency in government procurement.

The latter two areas of work, which we consider first, are of very limited ambition and success, however.

A Working Party on GATS Rules was established by the Council on Trade in Services in March 1995 to carry out, among other tasks, the negotiating mandate contained in the GATS on government procurement in services. Meanwhile, WTO Members hold different views with respect to the scope of the mandate for negotiations, some considering that Article XIII excludes MFN treatment, market access and national treatment from the scope of the mandated negotiations.

Secondly, at the 1996 Singapore Ministerial Conference, Ministers decided to set up a Working Group to conduct a study on transparency in government procurement practices. The group’s work relating to a potential agreement on transparency in government procurement spanned four broad subject-areas: (i) the definition of government procurement and the scope and coverage of a potential agreement; (ii) the substantive elements of a potential agreement on transparency in government procurement, including various aspects of access to general and specific procurement-related information and procedural matters; (iii) compliance mechanisms of a potential agreement; and (iv) issues relating to developing countries, including the role of special and differential treatment as well as technical assistance and capacity building.

No agreement on modalities for negotiations having been reached at the Fifth Ministerial Conference held in Cancún in September 2003, on 1 August 2004, the WTO General Council adopted a decision which addressed, *inter alia,* the future handling of the issue of transparency in government procurement, as well as the issues of the relationship between trade and investment and the interaction between trade and competition. The Council agreed that “those issues will not form part of the Doha Work Programme and therefore no work towards negotiations (...) will take place within the WTO during the Doha Round.”

The WTO is therefore constrained in the activities that are of interest to all member states. Pursuant to the overall Secretariat Technical Assistance Plan, the Secretariat undertakes a substantial programme of technical assistance (TA) activities, often done in co-operation with other international organisations, regional bodies, expert bodies from WTO members, and academic institutions. Essential instruments on which such technical assistance can build are: The UNCITRAL Model Law on Public Procurement; the Guide to Enactment of the UNCITRAL Model Law on Public Procurement; the OECD Principles for Enhancing Integrity in Public Procurement; the United Nations Convention Against

[155] The following information stems from https://www.wto.org/english/tratop_e/gproc_e/gproc_e.htm

Corruption; the World Bank Guidelines for Procurement under IBRD Loans and IDA Credits; finally the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Integrity of the procurement process therefore is core.

2 The plurilateral Agreement on Government Procurement [156]

OECD-work brought in 1976 into the ongoing Tokyo Round of Trade Negotiations resulted in 1979 in the first Agreement on Government Procurement, covering central government entities and procurement of goods only. In parallel with the Uruguay Round, Parties to the Agreement held negotiations to broaden the coverage of the Agreement to purchases by sub-central government entities and other public enterprises and to the services and construction services sectors. Following these negotiations, the Agreement on Government Procurement (1994) ('GPA') was signed in Marrakesh on 15 April 1994, at the same time as the Agreement Establishing the WTO. It led to an estimated ten-fold increase in the value of procurement subject to international competition under its rules. In December 2011, a decision on the outcomes of the re-negotiation of the Agreement, which had been on-going for more than a decade, was taken at Ministerial level in Geneva. The restricted membership in the GPA certainly helped spare this agreement from the general stalemate that affected the WTO and the Doha-negotiations. GPA parties have opened procurement activities worth an estimated US-$ 1.7 trillion annually to international competition.

The GPA is a plurilateral agreement under the WTO Agreement. Currently, forty-two WTO Members are covered by the WTO Agreement on Government Procurement, twenty-two other WTO Members have observer status under the Agreement of which nine are in the process of acceding to the agreement. Colombia, e,g,, contents itself with an observer status. However, the agreement serves broader purposes as we will illustrate below by way of the Free Trade Agreement concluded between Colombia and the EFTA-States.

The GPA is composed mainly of two parts: the text of the Agreement and parties' market access schedules of commitments:

- The outstanding feature in the body of the agreement is Article XVIII, requiring that all parties to the Agreement should establish domestic review systems that are timely, effective, independent, transparent and non-discriminatory. These systems permit suppliers to challenge breaches of the GPA and/or the national legislation giving effect to the Agreement. The review body, which may be an administrative authority or a court, must have the authority to implement remedial measures and/or to insure compensation for the loss or damages suffered by a supplier. Rapid interim measures must also be available to preserve a supplier's opportunity to participate in relevant procurement activities, where appropriate. Since effective suppliers can act on their proper initiative, the dispute settlement mechanism of the WTO, also available based on the GPA, is rarely used.
- The schedule of commitments of each party contains seven annexes under the revised GPA where the central government entities (annex 1), the sub-central government entities (annex 2), the other entities (annex 3), the goods (annex 4), the services (annex 5) and the construction services (annex 6) covered by the provisions of the agreement are listed, annex 7 containing general notes.

The very detailed procedural provisions of the GPA will be presented below in the section on the Colombia-EFTA-FTA. Regarding the schedule of commitments, two particularities deserve mentioning: First, given that the United States can not commit US States internationally unless they have conferred such power to the Federal State, the GPA covers only 37 US-States. Besides agriculture, the fact that the US could not open procurement at the level of municipalities and in all states had been the second stumbling block of free trade negotiations between Switzerland and the US occurring around 2005. Secondly, the EU has concluded public procurement agreements on a bilateral basis with a coverage that is larger than the contracting parties' respective commitments under the GPA. The public procurement agreement between Switzerland and the EU covers, e.g., also municipalities and "the sectors", i.e. enterprises in the different branches of the infrastructure sector holding exclusive rights, independently whether they are in public or private possession. Threshold values may also differ with respect to the GPA and at least within the EU, the principle of non-discrimination applies

[156] Information from https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm

also below the thresholds due to the general principle of non-discrimination applicable among economic agents of the EU. Furthermore, in the area of substantive provisions, the EU is in the process of developing a new tendering procedure, the ‘public procurement competitive dialogue’, a flexible procedure suited for particularly complex procurements which preserves not only competition between economic operators but also the need for the contracting authorities to discuss all aspects of the contract with each candidate. For the rest, it is remarkable and testifying for the relevance of the GPA agreement that not only a bilateral agreement concluded by the EU and Switzerland, two GPA members, essentially extends provisions of a multilateral agreement. The GPA is also providing the basis for procurement chapters in a series of other free trade agreements, as this is the case for the Colombia – EFTA-FTA. This fact is essentially due to the very detailed provisions figuring in the GPA which leave to the national legislator only room for the adoption of limited complementary rules.

3 The public procurement chapter in the Colombia-EFTA-FTA

The importance of public procurement in free trade negotiations is established by the fact that to liberalise purchases by public entities figures as letter d) in the overall enumeration of the objectives of the Colombia-EFTA-FTA. In fact, Article I reads:

“The objectives of this Agreement are:

(a) to achieve the liberalisation of trade in goods, in conformity with Article XXIV of the GATT 1994;
(b) to achieve the liberalisation of trade in services, in conformity with Article V of the GATS;
(c) to substantially increase investment opportunities in the free trade area;
(d) to achieve further liberalisation on a mutual basis of the government procurement markets of the Parties
(e) to promote competition in their economies, particularly as it relates to economic relations between the Parties;
(f) to ensure adequate and effective protection of intellectual property rights;
(g) to contribute, by the removal of barriers to trade and investment, to the harmonious development and expansion of world trade; and,
(h) to ensure co-operation related to trade capacity building, in order to expand and improve the benefits of this Agreement, specially for small and medium-sized enterprises.

Chapter 7 then covers in detail the procurement for governmental purposes of goods, services, or any combination thereof. Covered is procurement by any contractual means, including purchase, lease, rental or hire purchase, with or without an option to buy**,** for which the value equals or exceeds the relevant threshold specified in Annex XIX, provided that it is conducted by a procuring entity figuring in Annex XIX. The overarching goal of the chapter is to submit public procurement to the general principles of National Treatment and Non-Discrimination.[157]

An essential aspect of procurement agreements are the detailed provisions they contain regarding the conduct of procurement. A procuring entity shall not only conduct covered procurement in a transparent and impartial manner, avoid conflicts of interest; and prevent corrupt practices. It has in particular also to use one of three tendering procedures, namely either open tendering or selective tendering, or - under restrictions specified in a separate article - limited tendering in accordance with fixed thresholds:

(a) “open tendering” means a procurement method where all interested suppliers may submit a tender;

[157] The provisions of Chapter 7 do not apply to non-contractual agreements or any form of assistance that a Party, including a government enterprise, provides, including co-operative agreements, grants, loans, subsidies, equity infusions, guarantees, and fiscal incentives; the procurement or acquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions, or services related to the sale, redemption and distribution of public debt including loans and government bonds, notes and other securities; procurement funded by international grants, loans, or other assistance where the applicable procedure or condition would be inconsistent with this Chapter; public employment contracts; the acquisition or rental of real estate. Also, nothing in the chapter on public procurement shall be construed to prevent a Party from adopting or maintaining measures: necessary to protect public morals, order or safety; necessary to protect human, animal or plant life or health (the Parties understanding that this includes environmental measures necessary to protect human, animal or plant life or health); necessary to protect intellectual property; or relating to goods or services of persons with disabilities, philanthropic institutions, or prison labour.

(b) "selective tendering" means a procurement method whereby only qualified suppliers are invited by the procuring entity to submit a tender; "qualified supplier" means a supplier that a procuring entity recognises as having satisfied the conditions for participation;[158]

(c) "limited tendering" means a procurement method whereby the procuring entity contacts a supplier or suppliers of its choice;

The restrictive conditions under which limited tendering may take place read as follows:

(a) where no tenders were submitted, or no supplier requested participation; no tenders that conform to the essential requirements of the tender documentation were submitted; no suppliers satisfied the conditions for participation; or the tenders submitted have been collusive;

(b) where the goods or services can be supplied only by a particular supplier and no reasonable alternative or substitute goods or services exist for any of the following reasons: the requirement is for a work of art; the protection of patents, copyrights or other exclusive rights; or due to an absence of competition for technical reasons;

(c) for additional deliveries by the original supplier of goods or services that were not included in the initial procurement where a change of supplier for such additional goods or services cannot be made for economic or technical reasons such as requirements of interchangeability or interoperability with existing equipment, software, services or installations procured under the initial procurement and would cause significant inconvenience or substantial duplication of costs for the procuring entity;

(d) insofar as is strictly necessary where, for reasons of extreme urgency brought about by events unforeseeable by the procuring entity, the goods or services cannot be obtained in time using an open or selective tendering procedure, and the use of such procedures would result in serious injury to the procuring entity;

(e) for purchases made on a commodity market;

(f) where a procuring entity procures prototypes or a first product or service which are developed at its request in the course of, and for, a particular contract for research, experiment, study or original development;

(g) for purchases made under exceptionally advantageous conditions that only arise in the very short term in the case of unusual disposals such as those arising from liquidation, receivership, public auction or bankruptcy, but not for routine purchases from regular suppliers; or

(h) where a contract is awarded to a winner of a design contest provided that the contest has been organised in a manner that is consistent with the principles of this Chapter, in particular relating to the publication of a notice of intended procurement and the participants are judged by an independent jury with a view to a design contract being awarded to a winner.

A procuring entity has to prepare a report in writing on each contract awarded under the limited tendering procedure.

A special problem arises with "public works concessions". The latter consist in a contract of the same type as a construction services contracts, except for the fact that the remuneration for the works to be carried out consists either solely in the right to exploit the construction or in this right together with a payment.

To avoid chiselling by bringing the call for tender below the threshold where competition is open, forecasts of the costs of the project or purchase to be made need to be realistic. It is also prohibited to divide a procurement into consecutive purchases. Rather, calculation has to refer to the total maximum value of the procurement over its entire duration. The delimitation among construction work, goods and services has also some importance due to differing threshold values. "Construction service" means a service realised by whatever means falling under civil Division 51 of the United Nation's Central Product Classification (CPC).

The provisions regarding modifications of the offer express the guiding principle of equal treatment of all suppliers: Where, prior to the award of a contract, a procuring entity modifies the criteria or technical requirements a communication has to be made at the time the information is amended to all suppliers that are participating, if known, and in all other cases, in the same manner as the original information; and in adequate time to allow such suppliers to modify and re-submit amended tenders, as appropriate.

[158] Eventually, a procuring entity may establish a list of pre-qualified suppliers for certain categories of work.

Publication of procurement information: the published Notices have to comprise a description of the intended procurement, the procurement method, any conditions that suppliers must fulfil to participate in the procurement and shall limit such conditions to those that are essential to ensure that a supplier has the legal and financial capacities and the commercial and technical abilities to undertake the relevant procurement. The procurement entity may exclude a supplier only on grounds such as bankruptcy, false declarations, significant or persistent deficiencies in performance of any substantive requirement or obligation under a prior contract or contracts, final judgments in respect of serious crimes or other serious offences, professional misconduct or acts or omissions that adversely reflect upon the commercial integrity of the supplier, or failure to pay taxes.

Tender Documentation and Technical Specification have to enumerate all evaluation criteria to be considered in the awarding of the contract, and, except where price is the sole criterion, the relative importance of such criteria. In prescribing the technical specifications for the goods or services being procured, a procuring entity shall, where appropriate specify the technical specification in terms of performance and functional requirements, rather than design or descriptive characteristics, and base the technical specification on international standards where such exist or otherwise on national technical regulations, recognised national standards or building codes. A procurement entity may, in accordance with the general principles regarding technical specification, prepare, adopt, or apply technical specifications to promote the conservation of natural resources or protect the environment. A procuring entity may not prescribe any technical specifications that require or refer to a particular trademark or trade name, patent, copyright, design or type, specific origin, producer, or supplier, unless there is no other sufficiently precise or intelligible way of describing the procurement requirements and provided that, in such cases, words such as "or equivalent" are also included in the tender documentation.

Time Limits: A procuring entity shall provide suppliers sufficient time to submit applications to participate in a procurement and prepare and submit responsive tenders, taking into account the nature and complexity of the procurement. Each Party shall apply time limits according to the conditions specified in Appendix 3 of Annex XX (General Notes). Where an entity requires suppliers to satisfy qualification requirements in order to participate in a procurement, the entity shall provide no less than 25 days between the date on which the notice of intended procurement is published and the final date to submit the requests for participation and no less than 40 days between the date of issuance of the invitation to tender and the final date for submission of tenders. There are, however, possibilities for reducing the general time limits.

Negotiations: A Contracting Party may provide for its entities to conduct negotiations in the context of procurements in which they have indicated such intent in the notice of intended procurement; or where it appears from the evaluation that no one tender is obviously the most advantageous in terms of the specific evaluation criteria set forth in the notices or tender documentation.

A procuring entity shall receive and open all tenders under procedures that guarantee the fairness and impartiality of the procurement process and the confidentiality of tenders. It also shall treat tenders in confidence until at least the opening of the tenders.

Where a procuring entity receives a tender with a price that is abnormally lower than the prices in other tenders submitted, it may verify with the supplier that it can comply with the conditions of participation and is capable of fulfilling the terms of the contract.

A procuring entity may not cancel a procurement or terminate or modify awarded contracts in a manner that circumvents the obligations under this Chapter.

Subject to the article on the disclosure of information which protects the business secret of the suppliers, a procuring entity shall, on request, provide an unsuccessful supplier with an explanation of the entity´s reasons for not selecting that supplier's tender and the relative advantages of the successful supplier's tender.

Publication of Award Information: Not later than 72 days after an award, a procuring entity shall publish in a paper or electronic medium listed in Appendix 2 to Annex XX (General Notes) a notice that includes at least the following information about the contract: the name and address of the procuring entity; a description of the goods or services procured; the date of award; the name and address of the successful supplier; the contract value; and the procurement method used and, in cases where a procedure has been used pursuant to paragraph 8 of Article 7.10 (limited tendering procedures), a description of the circumstances justifying the use of such procedure. The information shall include information on the characteristics and relative advantages of the successful tender.

Domestic Review Procedures for Supplier Challenges: Each Party shall provide a timely, effective, transparent and non-discriminatory administrative or judicial review procedure according to the due process principle through which a supplier may challenge alleged breaches of this Chapter arising in the context of covered procurements in which the supplier has, or has had, an interest. Each supplier shall be allowed a sufficient period of time to prepare and submit a challenge, which in no case shall be less than ten days from the time when the basis of the challenge became known or reasonably should have become known to the supplier. Each Party shall establish or designate at least one impartial administrative or judicial authority that is independent of its procuring entities to receive and review a challenge by a supplier arising in the context of a covered procurement, and to make appropriate findings and recommendations. Corrective action shall be decided or compensation for the loss or damages suffered shall be paid, which may be limited to either the costs for the preparation of the tender or the costs relating to the challenge, or both.

Small and Medium Sized Enterprises Participation: The Parties agree on the importance of the participation of small and medium sized enterprises (SME) in government procurement. The Parties also recognise the importance of business alliances between suppliers of each Party, and in particular of SMEs. The Parties agree to work jointly towards exchanging information and facilitating SMEs access to government procurement procedures, methods and contracting requirements, focused on SMEs special needs.

The coverage of the Colombia-EFTA-FTA is remarkable. Although Colombia is not part of the GPA, the opening up essentially reaches the Switzerland-EU-level, so that Swiss enterprises have a larger guaranteed access to public procurement in Colombia than in the US.

On the Colombian side, procurement by the following list of entities is covered: The executive, legislative and judicial branch of the central government plus the control agency for food, all of the Departamentos and all of the Municipios, exempting any entity with an industrial or commercial character. On the Swiss side, within the infrastructure services, the contracting entities fall under the agreement which are public authorities or public undertakings and which have as at least one of their activities any of those referred to below:

1. the provision or operation of fixed networks intended to provide a service to the public in connection with the production, transport or distribution of drinking water or the supply of drinking water to such networks (as specified under Title I);
2. the operation of fixed networks providing a service to the public in the field of transport by tramway, trolleybus, bus or cable (as specified under Title II);
3. the exploitation of a geographical area for the purpose of the provision of airport or other terminal facilities to carriers by air (as specified under Title III);
4. the exploitation of a geographical area for the purpose of the provision of inland port or other terminal facilities to carriers by inland waterway (as specified under Title IV).
5. the electricity sector.

The specifications under the Titles I to IV exclude e.g. contracts for the purchase of water or contracts of entities exercising activities in the bus transportation sector where other entities are free to offer the same services in the same geographical area and under substantially the same conditions.

The appendix gives then an illustrative list of entities covered in the area of utilities, namely procurement by the stock company responsible for the provision of drinking water in the region of Berne, by the Transports Publics Genevois and, beyond the main airport of Switzerland, Zürich, e.g. also by the Aérodrome civil de Sion; finally, by the ports in the region of Basle.

Access is only contractually granted for orders above thresholds as indicated below:

Thresholds (in 1000 SDR[159])	Central State	Sub-national	Sectors Colombia	Sectors EFTA
Goods	130	200	220	400
Services	130	200	220	400
Construction	5000	5000	5000	5000

[159] 1000 SDR corresponded to some US-$ 1400 towards the endof 2015.

Guarantees for access to markets below the thresholds are quasi absent. The agreement states that "in their procedures and practices for the award of procurement contracts below the value of thresholds laid down in this Appendix, the Parties undertake to encourage their Covered Entities to treat the suppliers and service providers of the other Party in accordance with the provisions of Article 7.4 (National Treatment and Non-Discrimination).

The standard setting capacity of the GPA clearly appears through this FTA to which a non-GPA member is party. In fact, when a country is party to several FTAs, procedural rules can hardly differ among treaties; otherwise the administration would become burdensome and contradictions might arise. This is besides an illustration how service liberalisation cuts deeper into a national jurisdiction than tariff liberalisation does since the latter usually affects only a defined subset of the trans-border flow of goods while the former sets standards for transactions on a market in general. Discretion exists with regard to entities submitted and admitted but less so with regard to the standards the involved agents have to abide to. Agreed common standards will therefore often also make access for competitors of third parties easier, i.e. the latter content of agreements tends to be valid *erga omnes*. Usually, procurement entities are free to admit tenderers from countries not covered by a procurement agreement.

Chapter 9
Shielding Trade from Geopolitics

1 The freedom of transit[160]

International trade often requires the crossing of goods through the territory of other nations. For landlocked countries and regions, the transit across other States' territories to access international markets is even an indispensable condition for their integration in the international economy. Therefore, the right to pass through other countries, thereby benefitting from the use of simplified and harmonized procedures, including provisions for swift border formalities and non-discriminatory access to transportation facilities, are of particular importance for the development of trade.

Freedom of transit as a principle in international law is derived from the principle of the freedom of the Seas and the extension of this freedom to landlocked countries. Goods, means of transports as well as persons should enjoy freedom of transit in order to have access to the Sea. The freedom of the Seas was postulated back in the 17th century in particular by the Dutch lawyer Hugo Grotius and became part of the customary law of nations. In the 19th century, the adoption of acts on the freedom of navigation on the Rhine constitutes an interesting example of an extension of the freedom of the Seas to inland waterways (see part IV of Chapter 10 in the underlying publication). In the 20th century, access to and from the Sea and passage rights across the territories of other nations became then the subject of various international conferences and several international conventions. Commencing with the Barcelona Statute on freedom of transit (1921), the principle of freedom of transit was laid down in Article V of the GATT 1947, the New York Convention on Transit Trade of Landlocked Countries (1965), and the United Nations Convention on the Law of the Sea (UNCLOS III) (1982).

The ability to enjoy freedom of transit is limited by the sovereignty of states over their territory, however. The question of the right to transit and the duty of the transit state to allow transit across its territory remains therefore a contentious issue in international law. As such, the texts of the New York Convention and UNCLOS III stipulate that the exercise of the right of free and unrestricted access to the Sea shall in no way infringe the legitimate interests of the transit state. Consequently, it is understood, that whilst enjoying freedom of transit, there is also a right for the transit state to set requirements for granting access or transit rights. Such access and transit rights regulate the terms and modalities of the exercise of this freedom and are in general subject to bi- or multilateral negotiations. Among the various national regulations transit must comply with figure traffic and transport laws, licenses requirements, vehicle safety standards, environmental laws and immigration rules.

General restrictions of the freedom of transit

It is recognised that based on existing international law, freedom of transit and the freedom of access to the Sea cannot be absolutely restricted by the transit state. Absolute restrictions are only considered lawful if they are applied on a temporary and exceptional basis – justified by war and civil unrest. Furthermore, it is possible to restrict access for certain categories of goods on the ground of protection of public health and security (Barcelona Statute) or public moral, plant and animal diseases (New York Convention). Such restrictions on goods in transit may include traffic in weapons and drugs.

Freedom of transit also covers the means of transportation. Whilst some conventions and legal texts exhaustively list means of transports, the GATT Article V is tacit with regard to the means of transport covered. Implicitly, this means that in the GATT context transit also extends to modes such as pipelines, gas lines and electricity grids while it is understood that states can include in the respective bilateral or regional agreements restrictions on the means of transport enjoying freedom of transit such as excluding inland waterways.

Bilateral, regional and plurilateral agreements

Accordingly, numerous bilateral transit and transport agreements are in place. They generally make reference to existing international practice and rules and contain provisions determining the scope of application of the freedom of transit (e.g. including or not the persons), designating transit routes (limited to certain routes or not),

[160] Essentially based on UNCTAD, Freedom of Transit and Regional Transit Arrangements, see http://unctad.org/en/Docs/TN08_FreedomofTransit.pdf

regulating permits/quotas, procedures and documents, visas, driving licences, cross-border cooperation, dispute settlement, technical specifications of vehicles and technical certifications, motor vehicle third-party insurance, customs transit issues, etc.. There is a recent trend in bilateral agreements to include also provisions on road safety and security with a view to mitigate the risks of accidents, nuisance to population, and secure financial liability in case of accidents.

In parallel to the bilateral agreements, the trend in recent years points towards more comprehensive solutions at the regional level with a view to establishing or enhancing integrated and harmonized transit and transport systems and corridors supporting regional economic integration.[161] These regional agreements cover some elements such as regional harmonization of customs transit procedures and documents, regional cooperation between authorities in particular at border posts and regional customs transit guarantee systems. The next subsection lists a number of trade facilitating tools.

Tools available

World Customs Organization (WCO)

WCO instruments include: The Revised Kyoto Convention of the WCO on the Simplification and Harmonization of Customs Procedures (1999) Special Annex E1, Transit; and the WCO Customs Data Model. See www.wcoomd.org.

UNECE instruments

Relevant UNECE instruments and standards include: The International Convention on the Harmonisation of Frontier Controls of Goods; the United Nations Layout Key for Trade Documents (UNLK, ISO 6422); the United Nations Trade Data Elements Directory (UNTDED, ISO 7372); the United Nations Electronic Data Interchange for Administration, Commerce and Transport (UN/EDIFACT); or the UN/CEFACT Single Window Recommendation 33 (see www.unece.org/trans, www.unece.org/cefact). The ambition is to establish unified border control procedures such as customs controls, medico-sanitary inspections, veterinary inspections, phytosanitary inspections, controls of compliance with technical standards and quality controls. The idea is also to allow for joint controls of goods and documents through the provision of shared facilities, same opening hours and same types of services at the same border. Thus, the one-stop-one-shop principle for border controls is also contained.

TIR Convention

The TIR Convention stipulates that goods carried under the TIR procedure in approved and sealed road vehicles, or a combination of vehicles and containers, are not subject to customs examination, unless irregularities are suspected. The Convention reduces the regular requirements of national transit procedures while avoiding the need for physical inspection during transit other than checking seals and the external conditions of the load compartment or container. In addition, it dispenses with the need to operate national guarantees and national systems of documentation. See www.unece.org/trans/bcf/tir/welcome.html.

UNCTAD

UNCTAD has released various reports and technical notes, e.g. the document “Regional cooperation in transit transport: Solutions for landlocked and transit developing countries”, 2007 (TD/B/COM.3/EM.30/2). Technical Notes cover topics as disciplines on the levy of fees and charges, single national enquiry points, risk management for customs control, simplification of trade documentation using international standards, border agency coordination, bonded customs transit. UNCTAD has launched the Multi-Agency Working Group on Trade Facilitation.

The Global Facilitation Partnership for Transportation and Trade (GFP)

The Global Facilitation Partnership for Transportation and Trade (GFP) brings together the world’s leading organisations and practitioners in trade and transport facilitation. It creates an open information and exchange platform on major new developments and all aspects of trade and transport facilitation. See www.gfptt.org.

Case law to GATT V

Article V of the GATT (Freedom of Transit) provides for freedom of transit of goods, vessels and other means of transport across the territory of WTO members via the routes most convenient for international transit whereby international transit is defined as follows: Goods (including baggage), and also vessels and other means of transport, shall be deemed to be in transit across the territory of a contracting party when the passage across such territory, with or without transshipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across

[161] For the ASEAN Framework Agreement on the Facilitation of Goods in Transit and further developments see http://www.aseansec.org; information on transit issues in the EU may be found on http://ec.europa.eu/taxation_customs/customs/procedural_aspects/transit/index_en.htm

whose territory the traffic passes. It then specifies:[162]

- equal treatment independent of a vessel's flag, origin, departure, entry, exit, destination or ownership of the goods or vessels;
- prohibition of unnecessary delays or restrictions to traffic in transit;
- prohibition to levy customs duties, transit duties and other transit-related charges (except for charges for transportation or those commensurate with administrative expenses entailed by transit, or with the costs of services rendered);
- level of charges levied should be reasonable for the conditions of traffic;
- most favoured nation treatment with regard to charges, regulations and formalities.

A dispute between Colombia and Panama[163] offered to the WTO Dispute Settlement Body the opportunity to clarify the notion of "routes most convenient for transit". The case looks as follows: On 12 July 2007, Panama requested consultations with Colombia on (i) indicative prices applicable to specific goods and (ii) restrictions on ports of entry for certain goods. In relation to restrictions on ports of entry, Panama's request for consultations was directed at a resolution of June 2007 which provided that all goods classifiable in Chapters 50-64 of the Customs Tariff coming from the Free Zone of Colon in Panama shall be entered and imported exclusively through the jurisdictions of the Special Customs Administration of Bogota and the Barranquilla Customs Office. This requirement did not apply to goods arriving directly from third countries. Also, the regulation provided that with respect to these goods, the authorization of the customs transit procedure will not be appropriate.[164] After detailed examination of the arguments and statistics submitted by the parties, the panel rejected Colombia's view that these port of entry and transit restrictions were sufficiently efficient in combating the underreporting of the invoice price and in combating smuggling. Therefore, the panel upheld Panama's claims that the ports of entry measure is inconsistent with Article I:1, the first and second sentences of Article V:2, the first sentence of Article V:6, and Article XI:1 of the GATT 1994, and declined to rule separately on Panama's claims that this measure is inconsistent with Articles I:1 and XIII:1 of the GATT 1994. The panel further rejected Colombia's defence that the ports of entry measure is justified under Article XX(d) of the GATT 1994. At the DSB meeting on 19 June 2009, Colombia informed the DSB of its intention to comply and that it needed a reasonable period of time to comply with the DSB recommendations. An arbitrator then determined this period to be eight months and 15 days from the date of the adoption of the panel report. Implementation was notified to the DSB on 18 February 2010.

2 A Digression on the Law of the Sea

The United Nations Conferences on the Law of the Sea

The oceans had long been subject to the freedom-of-the-seas doctrine - a principle limiting national rights and jurisdiction over the oceans to a narrow belt of the Sea surrounding a nation's coastline (initially the 3 sea-miles projectiles could be fired from a cannon based on the shore). The remainder of the Seas was proclaimed to be free to all and belonging to none. While this situation prevailed into the twentieth century, by mid-century there was an impetus to extend national claims over offshore resources.[165] There was also a growing concern over the toll taken on coastal fish stocks by long-distance fishing fleets and over the threat of pollution and wastes from transport ships and oil tankers carrying noxious cargoes, threatening in case of disaster coastal resorts and all forms of ocean life. In parallel, the navies of the maritime powers continued to compete in maintaining a presence across the globe on the surface waters and under the sea.

To address these concerns, the United Nations convened a Conference on the Law of the Sea relatively soon after the movement to extend national authority over formerly international waters had set in. UNCLOS I resulted in four treaties

[162] United Nation's Economic Commission for Europe (UNECE): Trade facilitation implementation guide, http://tfig.unece.org/index.html

[163] https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds366_e.htm

[164] Apparently, lorries loaded with textiles arrived on ferries and quickly left the port based on the TIR facility; Colombia tried to block this by interdicting the change in the mode of transport from ship to camion.

[165] In 1945, President Harry S Truman, responding in part to pressure from domestic oil interests, unilaterally extended United States jurisdiction over all natural resources on that nation's continental shelf - oil, gas, minerals, etc. This was the first major challenge to the freedom-of-the-seas doctrine. Soon, other nations followed suit.

concluded in 1958 in Geneva and the creation of a dispute settlement mechanism:[166]

1) The Convention on the Territorial Sea and the Contiguous Zone established sovereignty rights and rights of passage through the territorial sea, defined the Contiguous Zone to extend 12 nautical miles from the baselines, but failed to set standards on limits of the territorial sea;

2) The Convention on the High Seas established access for landlocked nations, expounded on the concept of "flag state," outlawed the transport of slaves, covered piracy, established safety and rescue protocols, established a national duty to prevent pollution, and established rights to laying of undersea cables and pipelines;

3) The Convention on Fishing and Conservation of the Living Resources of the High Seas established the right of coastal nations to protect living ocean resources, required nations whose fleets leave their territorial sea to establish conservation measures, and established measures for dispute resolution;

4) The Convention on the Continental Shelf established the regime governing the super-jacent waters and airspace, the laying and maintenance of submarine cables or pipelines, the regime governing navigation, fishing, scientific research and the coastal nation's competence in these areas, delimitation, and tunnelling.

5) The Convention also produced an Optional Protocol of Signature Concerning the Compulsory Settlement of Disputes.

Although UNCLOS I was considered a success, it left open the important issue of the breadth of the territorial waters. In 1960, the United Nations held the second Conference on the Law of the Sea ("UNCLOS II"); however, the six-week Geneva conference did not result in any new agreements. At these times, developing nations and third world countries participated only as clients, allies, or dependents of the United States or the Soviet Union, with no significant voice of their own.

UNCLOS III then had a much broader attendance and was indeed capable of adding considerable substance to the law of nations as we will presently see.

On 1 November 1967, Malta's Ambassador to the United Nations, Arvid Pardo, in a speech to the United Nations General Assembly, called for "an effective international regime over the seabed and the ocean floor beyond a clearly defined national jurisdiction". Pardo's urging came at a time when many recognized the need for updating the freedom-of-the-seas doctrine to take into account the technological changes that had altered man's relationship to the oceans. What started as an exercise to regulate the seabed turned into a global diplomatic effort to regulate and write rules for all ocean areas, all uses of the seas and all of its resources. The process that spanned over 15 years culminated 1982 in the adoption of a constitution for the seas - the United Nations Convention on the Law of the Sea. Additionally, the Conference saw the creation of the United Nations Seabed Committee, the signing of a treaty banning nuclear weapons on the seabed, the adoption of the declaration by the General Assembly that all resources of the seabed beyond the limits of national jurisdiction are the common heritage of mankind and the convening of the Stockholm Conference on the Human Environment.

Key Provisions of UNCLOS III[167]

Some of the key features of the Convention are the following:

* Delimitation of the territorial sea

Coastal States exercise sovereignty over their territorial sea; they have the right to establish the breadth of the territorial sea up to a limit not to exceed 12 nautical miles; foreign vessels are allowed "innocent passage" through those waters

As the work of UNCLOS III progressed, the move towards a 12-mile territorial sea gained wider and eventually universal acceptance. In addition to their right to enforce any law within their territorial seas, coastal States are also empowered to implement certain rights in an area beyond the territorial sea, extending for 24 nautical miles from their shores, for the purpose of preventing certain violations and enforcing police powers. This area, known as the "contiguous zone", may be used by a coast guard or its naval equivalent to pursue and, if necessary, arrest and detain suspected drug smugglers, illegal immigrants and customs or tax evaders violating the laws of the coastal State within its territory or the territorial sea.

[166] http://www.eoearth.org/view/article/156775/

[167] The headings marked by an asterisk are taken from the homepage of the United Nation's Division on Ocean Affairs and the Law of the Sea except for the text on the right of transit which reflects directly UNCLOS III (see http://www.un.org/Depts/los/convention_agreements/convention_historical_perspective.htm#Historical Perspective

* Passage through straits

Ships and aircraft of all countries are allowed "transit passage" through straits used for international navigation; States bordering the straits can regulate navigational and other aspects of passage

A 12-mile territorial sea would place under national jurisdiction of riparian States strategic passages such as the Strait of Gibraltar (8 miles wide and the only open access to the Mediterranean), the Strait of Malacca (20 miles wide and the main sea route between the Pacific and Indian Oceans), the Strait of Hormuz (21 miles wide and the only passage to the oil-producing areas of Gulf States) and Bab el Mandeb (14 miles wide, connecting the Indian Ocean with the Red Sea).[168] The regime of transit passage retains the international status of the straits and gives the naval Powers the right to unimpeded navigation and overflight that they had insisted on. Ships and vessels in transit passage, however, must observe international regulations on navigational safety, civilian air-traffic control and prohibition of vessel-source pollution and the conditions that ships and aircraft proceed without delay and without stopping except in distress situations and that they refrain from any threat or use of force against the coastal State. In all matters other than such transient navigation, straits are to be considered part of the territorial sea of the coastal State.

The Turkish Straits

Of particular relevance for the countries bordering the Black Sea and Central Asia in general, the Turkish Straits (i.e. the succession of the Bosporus (700m wide), the Sea of Marmara, and the Dardanelles (1.2km wide)), all part of the sovereign sea territory of Turkey, are also subject to the regime of internal waters. The Straits have been of urgent maritime strategic importance since the Trojan War was fought near the Aegean entrance. An interest to bar Russia access to the Mediterranean Sea then dominated from the 19th century on (see, e.g., the war over the Crimean Peninsula). In WWI, i.e. in the declining days of the Ottoman Empire, a major battle was fought regarding control over the Dardanelles. In 1923 the Treaty of Lausanne had demilitarised the Dardanelles and opened the Straits to unrestricted civilian and military traffic, under the supervision of the International Straits Commission of the League of Nations. The aggressive Italian policy in the Mediterranean ("mare nostrum") led to a reversal, strengthening Turkey's position. The modern treaty controlling access from the Black Sea to the Mediterranean is the 1936 Montreux Convention Regarding the Regime of the Turkish Straits, which is still in force, given Turkey's refusal to sign UNCLOS III. It gives the Republic of Turkey considerable control over warships entering the straits but guarantees the free passage of civilian vessels at least in peacetime. For more details see http://en.wikipedia.org/wiki/Montreux_Convention_Regarding_the_Regime_of_the_Straits

* Archipelagic States

Archipelagic States, made up of a group or groups of closely related islands and interconnecting waters, have sovereignty over a sea area enclosed by straight lines drawn between the outermost points of the islands

The regime for archipelagic States (States such as the Philippines and Indonesia, which are made up of a group of closely spaced islands) was a new feature in international law UNCLOS III established. In archipelagic waters, States may establish sea lanes and air routes in which all other States enjoy the right of archipelagic passage through such designated sea lanes.

* Freedom of transit

Land-locked States have the right of access to and from the sea and enjoy freedom of transit through the territory of transit States

Freedom of transit is granted for the purpose of exercising the rights provided for in the Convention, including those relating to the freedom of the high Seas and the common heritage of mankind. As an expression of the latter, the convention e.g. states that ships flying the flag of land-locked States shall enjoy treatment equal to that accorded to other foreign ships in maritime ports. In order to allow the exercise of these rights, the convention acknowledges the freedom of transit. In substance, there is a large overlap with GATT V, but the convention is more explicit in the sense that it says that the terms and modalities for exercising freedom of transit shall be agreed between the land-locked States and transit States concerned through bilateral, sub-regional or regional agreements. To enhance the readiness of transit states to conclude such agreements, the application of the most-favoured-nation clause is suspended, the creation of free zones and other customs facilities for landlocked countries admitted and the cooperation in the construction and improvement of means of transport encouraged. With regard to means of transport, the convention

[168] See box for the straits linking the Black Sea to the Mediterranean Sea.

is more precise than GATT V since in Art. 124 it is said that "means of transport" means: “1.(d) (i) railway rolling stock, sea, lake and river craft and road vehicles; (ii) where local conditions so require, porters and pack animals. 2. that landlocked States and transit States may, by agreement between them, include as means of transport pipelines and gas lines and means of transport other than those included in paragraph 1.” Different from GATT V, the requirement that the transit routes should be the most convenient cannot be found in UNCLOS III, while with regard to the MFN principle, the Interpretative note to GATT V (6) needs consideration. This note says that if, as a result of negotiations, a member grants to a country which has not direct access to the sea more ample facilities, such special facilities may be limited to the landlocked country concerned unless the Organisation finds, on the complaint of any other member, that the withholding of the special facilities from the complaining member contravenes the most-favoured-nation provisions of this Charter. Finally, considering the existence of such treaties as the Mannheim Act on navigation on the Rhine, UNCLOS III retains that: The convention does not entail in any way the withdrawal of transit facilities which are greater than those provided for in this Convention and which are agreed between States Parties to this Convention or granted by a State Party. This Convention also does not preclude such granting of greater facilities in the future.

* Exclusive Economic Zones

Coastal States have sovereign rights in a 200-nautical mile exclusive economic zone (EEZ) with respect to natural resources and certain economic activities, and exercise jurisdiction over marine science research and environmental protection; all other States have freedom of navigation and overflight in the EEZ, as well as freedom to lay submarine cables and pipelines

The exclusive economic zone (EEZ) is one of the most revolutionary features of the Convention, and had a profound impact on the management and conservation of the resources of the oceans. To the coastal State falls the right to exploit, develop, manage and conserve all resources - fish or oil, gas or gravel, nodules or sulphur - to be found in the waters, on the ocean floor and in the subsoil of an area extending 200 miles from its shore. The EEZs are a generous endowment indeed. About 87 per cent of all known and estimated hydrocarbon reserves under the sea fall under some national jurisdiction as a result. This is also the case for almost all known and potential offshore mineral resources, excluding the mineral resources (mainly manganese nodules and metallic crusts) of the deep ocean floor beyond national limits. The most lucrative fishing grounds too are predominantly the coastal waters. Indeed, the desire of coastal States to control the fish harvest in adjacent waters was a major driving force behind the creation of the EEZs. Each coastal State is to determine the total allowable catch for each fish species within its economic zone and is also to estimate its harvest capacity and what it can and cannot itself catch. Coastal States have certain other obligations, including the adoption of measures to prevent and limit pollution and to facilitate marine scientific research in their EEZs. Evidently, an essential driver for the creation of EEZ was the offshore oil. The Third United Nations Conference on the Law of the Sea was launched shortly after the October 1973 Arab-Israeli war with the subsequent oil embargo and skyrocketing of prices.

* Continental Shelf

Coastal States have sovereign rights over the continental shelf (the national area of the seabed) for exploring and exploiting it; the shelf can extend at least 200 nautical miles from the shore, and more under specified circumstances

Although many States had started claiming wide continental-shelf jurisdiction since the Truman Proclamation of 1945, these States did not use the term "continental shelf" in the same sense. In the mid-1950s, the International Law Commission made a number of attempts to define the "continental shelf" and coastal State jurisdiction over its resources. The Convention then resolved conflicting claims, interpretations and measuring techniques by setting the 200-mile EEZ limit as the boundary of the continental shelf for seabed and subsoil exploitation, satisfying the geologically disadvantaged. The nations with opposing interests - about 30 States, including Argentina, Australia, Canada, India, Madagascar, Mexico, Sri Lanka and France with respect to its overseas possessions - were satisfied with a broader shelf by giving them the possibility of establishing a boundary going out to 350 miles from their shores or further, depending on certain geological criteria. More precisely, in cases where the continental margin extends further than 200 miles, nations may claim jurisdiction up to 350 miles from the baseline or 100 miles from the 2,500 metre depth, depending on certain criteria such as the thickness of sedimentary deposits. These rights would not affect the legal status of the waters or that of the airspace above the continental shelf. To counterbalance the continental shelf extensions, coastal States must also contribute to a system of sharing the revenue derived from the exploitation of mineral resources beyond 200 miles. The Commission on the Limits of the Continental Shelf shall make recommendations to States on the shelf's outer boundaries when it extends beyond 200 miles. Rocks which could not sustain human habitation or economic life of their own would have no economic zone or continental shelf.

* Marine Pollution

States are bound to prevent and control marine pollution and are liable for damage caused by violation of their international obligations to combat such pollution

There are six main sources of ocean pollution addressed in the Convention: land-based and coastal activities; continental-shelf drilling; potential seabed mining; ocean dumping; vessel-source pollution; and pollution from or through the atmosphere. The Convention lays down, first of all, the fundamental obligation of all States to protect and preserve the marine environment. Coastal States are empowered to enforce their national standards and anti-pollution measures within their territorial sea and are granted jurisdiction for the protection and preservation of the marine environment of its EEZ. With regard to marine pollution from foreign vessels, coastal States can exercise jurisdiction only for the enforcement of laws and regulations adopted in accordance with the Convention or for "generally accepted international rules and standards". Such rules and standards, many of which are already in place, are adopted through the competent international organization, namely the International Maritime Organization (IMO). On the other hand, it is the duty of the "flag State", the State where a ship is registered and whose flag it flies, to enforce the rules adopted for the control of marine pollution from vessels, irrespective of where a violation occurs. This serves as a safeguard for the enforcement of international rules, particularly in waters beyond the national jurisdiction of the coastal State, i.e., on the high seas. Furthermore, the Convention gives enforcement powers to the "port State", since the port State can enforce any type of international rule or national regulations adopted in accordance with the Convention or applicable international rules as a condition for the entry of foreign vessels into its ports or internal waters or for a call at its offshore terminals. Finally, as far as the international seabed area is concerned, the International Seabed Authority, through its Council, is given broad discretionary powers to assess the potential environmental impact of a given deep seabed mining operation. States are to be held liable for any damage caused by either their own enterprise or contractors under their jurisdiction.

* Fishing

All States are obliged to adopt, or cooperate with other States in adopting measures to manage and conserve living resources

States bordering enclosed or semi-enclosed seas are particularly addressed and expected to cooperate in managing living resources, environmental and research policies and activities. Land-locked and geographically disadvantaged States have the right to participate on an equitable basis in exploitation of an appropriate part of the surplus of the living resources of the EEZ's of coastal States of the same region or sub-region; highly migratory species of fish and marine mammals are accorded special protection.

* Marine scientific research

All marine scientific research in the EEZ and on the continental shelf is subject to the consent of the coastal State, but in most cases they are obliged to grant consent to other States when the research is to be conducted for peaceful purposes and fulfils specified criteria

Within the EEZ and in cases involving research on the continental shelf, the coastal State must give its prior consent. However, such consent for research for peaceful purposes is to be granted "in normal circumstances" and "shall not be delayed or denied unreasonably", except under certain specific circumstances identified in the Convention. In case the consent of the coastal State is requested and such State does not reply within six months of the date of the request, the coastal State is deemed to have implicitly given its consent. These last provisions were intended to circumvent the long bureaucratic delays and frequent burdensome differences in coastal State regulations. States are bound to promote the development and transfer of marine technology "on fair and reasonable terms and conditions", with proper regard for all legitimate interests;

* Dispute settlement

States Parties are obliged to settle by peaceful means their disputes concerning the interpretation or application of the Convention

The mechanism for the settlement of disputes is incorporated into the document, making it obligatory for parties to the Convention to go through the settlement procedure in case of a dispute with another party. If direct talks between the parties fail, the Convention gives them a choice among four procedures - some new, some old: submission of the dispute to the International Tribunal for the Law of the Sea, adjudication by the International Court of Justice, submission to binding international arbitration procedures or submission to special arbitration tribunals with expertise in specific types of disputes. All of these procedures involve binding third-party settlement, in which an agent other than the parties directly involved hands down a decision that the parties are committed in advance to respect.

The only exception to these provisions is made for sensitive cases involving national sovereignty. In such circumstances, the parties are obliged to submit their dispute to a conciliation commission, but they will not be bound by any decision or finding of the commission. The moral pressure resulting was argued as being persuasive and adequate to ensure compliance with the findings. The Convention also contains so-called "optional exceptions", which can be specified at the time a country signs, ratifies or accedes to the Convention or at any later time. A State may declare that it chooses not to be bound by one or more of the mandatory procedures if they involve existing maritime boundary disputes, military activities or issues under discussion in the United Nations Security Council.

*Deep Seabed Mining (Part XI of UNCLOS III)

Resources of the seabed beyond the limits of national jurisdiction are declared the common heritage of mankind and deep seabed mining is accordingly placed under the International Seabed Authority

Deep seabed mining takes place at a depth of more than fifteen thousand feet of open ocean, thousands of miles from land. At the centre of the interest are potato-sized manganese nodules, first found on 13 March 1874 by a British research vessel, on the deep ocean floor and containing a number of important metals and minerals. In the 1950s, the potential of these deposits as sources of nickel, copper and cobalt ore was finally appreciated albeit technical difficulties to bring them to the surface subsist. One of the driving forces behind the Convention on the Law of the Sea, deep seabed mining should be administered by the International Seabed Authority, headquartered in Jamaica. The International Tribunal for the Law of the Sea established under the Convention has exclusive jurisdiction over deep seabed mining disputes. Disputes over seabed activities will be arbitrated by an 11-member Seabed Disputes Chamber, the Chamber having compulsory jurisdiction over all such conflicts, whether involving States, the International Seabed Authority or companies or individuals having seabed mining contracts.

Although motivating the work on the Convention, Part XI of UNCLOS III remains its most contested part. In particular in the United States, a vigorous debate over the ratification of the treaty took place. Although the administration of President G.W.Bush, the Pentagon and the Senate Foreign Relations Committee favoured ratification, a group of Republican senators blocked it, considering the involvement in this treaty as detrimental to the pursuit of U.S. national interests.[169] The United States now recognizes the UNCLOS as essentially representing a codification of customary international law.

3 Freedom of the air[170]

The freedoms of the air are a set of commercial aviation rights granting a country's airlines the privilege to enter and land in another country's airspace.

The first two freedoms concern the passage of commercial aircraft through foreign airspace and airports, the other freedoms are about carrying people, mail and cargo internationally. The first through fifth freedoms are officially enumerated by international treaties Therefore, the lower-numbered freedoms are relatively universal while the higher-numbered ones are rarer and are normally laid down in bilateral aviation agreements. Selected multilateral open skies agreements represent the least restrictive form of air services agreements and may include many if not all freedoms.

The Chicago Convention[171] drew up a multilateral agreement in which the first two freedoms were opened to all signatories. The agreement is known as the International Air Services Transit Agreement (IASTA) or "Two Freedoms Agreement". As of mid-2007, the treaty was accepted by 129 countries. However, Brazil, Russia, Indonesia, and China never joined, and Canada left the treaty in 1988. These large and strategically located non-IASTA-member states prefer to

[169] For more information on the issues at stake see a New York –Times article: http://www.nytimes.com/2005/10/10/science/as-polar-ice-turns-to-water-dreams-of-treasure-abound.html

[170] The following text is made up of selected assertions taken from the entry in Wikipedia on the freedoms of the air as of 20 February 2015 (http://en.wikipedia.org/wiki/Freedoms_of_the_air). The box with the eight freedoms is taken from the ICAO homepage (http://www.icao.int/Pages/freedomsAir.aspx).

[171] The Convention on International Civil Aviation, also known as the Chicago Convention, established the International Civil Aviation Organization (ICAO), a specialized agency of the United Nations charged with coordinating and regulating international air travel. The Convention establishes rules of airspace, aircraft registration and safety, and details the rights of the signatories in relation to air travel. The Convention also exempts commercial air fuels from tax. The Convention has since been revised eight times. As of 2013, the Chicago Convention had 191 state parties.

maintain tighter control over foreign airlines' overflight of their airspace, and negotiate transit agreements with other countries on a case-by-case basis. Since the end of the Cold War, first freedom rights are almost completely universal. Most countries require prior notification before an overflight, and may charge substantial fees for the privilege.

The third and fourth freedoms allow basic international service between two countries. Even when reciprocal third and fourth freedom rights are granted, air services agreements (e.g. the Bermuda Agreements) may still restrict many aspects of the traffic, such as the capacity of aircraft, the frequency of flights, the airlines permitted to fly and the airports permitted to be served.

Rights beyond the fourth freedom allow the carriage of traffic between (and sometimes within) countries that are foreign to the airlines that operate them. Today, the most controversial of these are fifth freedom rights.

The fifth freedom allows an airline to carry revenue traffic between foreign countries as a part of services connecting the airline's own country. Less controversial but still restricted at times, though relatively more common are sixth freedom rights. This freedom combines the third and fourth freedoms and is the right to carry passengers or cargo from a second country to a third country by stopping in one's own country. Only airlines flying between two foreign countries via home country on a single flight number require sixth freedom. The seventh freedom is a variation of the fifth freedom. It is the right to carry passengers or cargo between two foreign countries without any continuing service to one's own country.

Freedoms of the Air

First Freedom of the Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State or States to fly across its territory without landing.

Second Freedom of the Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State or States to land in its territory for non-traffic purposes.

Third Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down, in the territory of the first State, traffic coming from the home State of the carrier.

Fourth Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to take on, in the territory of the first State, traffic destined for the home State of the carrier.

Fifth Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State to put down and to take on, in the territory of the first State, traffic coming from or destined to a third State.

ICAO characterises all "freedoms" beyond the Fifth as "so-called" because only the first five "freedoms" have been officially recognized as such by an international treaty.

Sixth Freedom of The Air - the right or privilege, in respect of scheduled international air services, of transporting, via the home State of the carrier, traffic moving between two other States. The so-called Sixth Freedom of the Air, unlike the first five freedoms, is not incorporated as such into any widely recognised air service agreements such as the "Five Freedoms Agreement".

Seventh Freedom of The Air - the right or privilege, in respect of scheduled international air services, granted by one State to another State, of transporting traffic between the territory of the granting State and any third State with no requirement to include on such operation any point in the territory of the recipient State, i.e the service need not connect to or be an extension of any service to/from the home State of the carrier.

Eighth Freedom of The Air - the right or privilege, in respect of scheduled international air services, of transporting cabotage traffic between two points in the territory of the granting State on a service which originates or terminates in the home country of the foreign carrier or (in connection with the so-called Seventh Freedom of the Air) outside the territory of the granting State (also known as "consecutive cabotage").

Ninth Freedom of The Air - the right or privilege of transporting cabotage traffic of the granting State on a service performed entirely within the territory of the granting State (also known as "stand alone" cabotage).

Source: Manual on the Regulation of International Air Transport (Doc 9626, Part 4)

The eighth freedom is rare because it is usually not in the commercial interest of airlines, except in Europe where an EU open skies regime has seen many carriers, particularly low cost carriers, operate flights between two points, with neither of them being in their home country. The ninth freedom (stand alone cabotage) is the right to carry passengers or cargo within a foreign country without continuing service to or from one's own country, sometimes known as "stand alone cabotage." The EU agreements mentioned cover this ninth category. However, stand alone cabotage rises the question from when on an airline operating in a third country belongs to the third country in the sense that this country can claim that the airline has a commercial residence within this country. This question is relevant also in the context of road and rail transportation and we will take it up there.

4 European Transport Policy

Transportation networks are at the heart of trans-border supply chains. Accordingly, transport is a cornerstone of the European integration process and is firmly linked to the creation and completion of the internal market.[172] Transport is seen as vital for fulfilling three of the four freedoms of a common market as established in the Treaty of Rome in 1957: the free movement of individuals, services and goods. Over the past decades, developments in European transport policy have helped to strengthen the wider EU internal market by opening up national markets previously dominated by public monopolies, such as in aviation and rail. In addition, barriers to access, unnecessary differences in technical and administrative standards and distortions of competition across EU countries - pricing, taxes and other charges - are gradually being removed as part of the process of creating a genuine single European transport area across all forms of travel. This has largely been achieved in areas such as aviation, where a policy of market liberalisation initiated in the 90' sparked a period of unprecedented growth. Expanding, modernising and streamlining EU-wide infrastructure is also essential to create seamless cross-border networks across the different forms of travel. This is why the trans-European network policy was enshrined in the EU's Maastricht Treaty of 1992. In addition, the Treaty incorporated environmental protection requirements into transport policy as a tool to help complete the internal market.

Infrastructure Development

With the trans-European transport network, or TEN-T, the EU plans to establish a core network by 2030, filling in missing cross-border links and making the network 'smarter', with deadlines to make sure that all projects contributing to the core network are implemented as a priority. The core network will be supported by a comprehensive network of routes that feed into it, regionally and nationally. Standards are set to ensure that trains, ships, planes, trucks and cars can use the infrastructure safely and without any technical problems. Transport financing under the Connecting Europe Facility for the period 2014–20 will also focus on this core transport network.

The map on the next page shows the TEN-T network.

Transport Legislation

EU transport legislation includes as landmark pieces the three railway packages, which began a gradual liberalisation of national rail markets, laws on road and maritime 'cabotage' (the transport of goods or passengers between two points in the same country by transporters registered in another country), and the two single European sky packages, which aim to create one European airspace under a set of common aviation rules.

Below follow a few more indications regarding the integration of the markets for transportation by either rail, air, road or waterways.

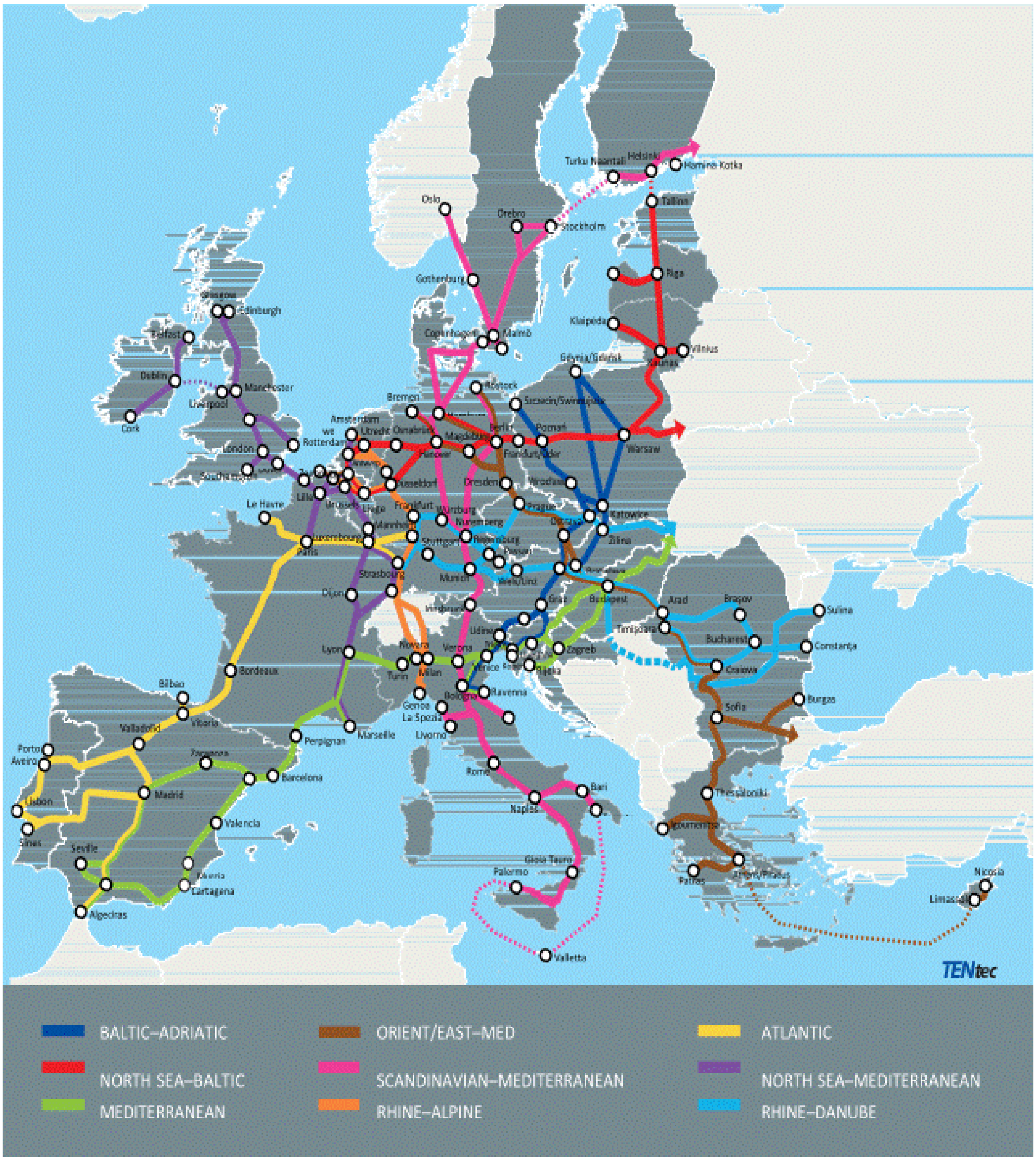
- *Rail*

By the late 80', freight transport by road was becoming more competitive, and by comparison railways were performing poorly. The first major move to reform rail transport came in 1991, with a cautious opening of the rail networks to competition. Liberalisation of the rail sector, particularly for freight, was pushed forward with moves to separate infrastructure and operations through a series of legal changes known as the three 'railway packages'. After many years of stagnation and decline, since 2001 the European railway industry has managed to increase its passenger and freight volumes and to stabilise its market share among other modes of transport.

- *Aviation*

In the years following the Treaty of Rome, air transport was organised based on national public

[172] The source of this and the following paragraphs is: europa.eu/pol/pdf/flipbook/en/transport_en.pdf



The TEN-T network will transform connections, remove bottlenecks, upgrade infrastructure and streamline cross- border transport operations

regulation of competition conditions rather than on the free market. This led to a series of fragmented markets, national monopolies and very high tariffs. At that time, air transport was regulated by Member State bilateral agreements. The aviation market was gradually liberalised through three successive packages of measures which covered air carrier licensing, market access and fares. These removed the restrictions that had limited air transport markets in Europe and prevented cross-border investment by European airlines.

In 1992 there were just 93 European routes served by more than two airlines. In 2011, there were 482 such routes. The third (and most significant) package established the principle of full freedom to provide services within the single market and replaced the concept of 'national or flag carriers' with that of European airlines competing with each other.

In 2004, an ambitious initiative for a Single European Sky (SES) was launched to streamline air traffic management by collectively managing airspace. One of its main objectives is to replace the

28 national airspace systems with one to cover the entire EU. This would increase efficiency and cut costs.

- *Road*

Economically, road is the main form of transport for freight. It accounts for the bulk of inland transport in the European Union and has been growing steadily in recent decades. It took around 10 years between the mid-1980s and mid-1990s for Europe to open up its international road freight market and remove barriers to competition, such as the licences required for a road haulier to gain access to another country's market, quotas to limit the capacity of road traffic and tariffs.

The success of opening up this market throughout the EU is demonstrated by increases in international cross-trade and 'cabotage', where hauliers are permitted to offer their services for domestic journeys in other Member States. However, cabotage accounts for only a small share of domestic haulage markets and remains limited by legislation.

Cabotage, a major issue in road transportation

The notion of cabotage originates in the rules applicable to coastal navigation, but similar problems arise when other means of transport are used as we have already seen with regard to air transportation. Here, we will consider road transportation, but coastal navigation, the utilisation of railway stock or the usage of internal waterways create similar regulatory challenges.

With regard to road transportation, EC regulation No 1072 of 21 October 2009 on common rules for access to the international road haulage market regulates cabotage in Chapter II, Article 8. It stipulates first that any haulier for hire or reward who is a holder of a Community licence shall be entitled to carry out cabotage operations. The conditions are that once the goods carried in the course of an incoming international carriage have been delivered, the hauliers can undertake up to three cabotage operations but the last unloading in the course of a cabotage operation before leaving the host Member State shall take place within 7 days from the last unloading in the host Member State in the course of the incoming international carriage. Within this time limit, hauliers may carry out some or all of the cabotage operations permitted under that subparagraph in any Member State under the condition that they are limited to one cabotage operation per Member State within 3 days of the unladen entry into the territory of that Member State.

Progress in opening up the market for passenger transport services has been slower. In 1992, European coach and bus operators were allowed to run international passenger transport services between Member States. Now, commercial EU carriers may transport passengers by bus and coach across the EU road network based on a European licence issued by the country where they are based.

Another sensitive issue over the decades in the road transport sector has been road charges and tolls. EU policy has two objectives in this area: firstly, any charges must not be excessive or discriminate against foreign drivers compared with those of the Member State concerned; secondly, charges should be consistent with the 'user pays' and 'polluter pays' principles, and help pay for the maintenance and development of transport infrastructure. A key piece of legislation was the Eurovignette directive, passed in 1999 to charge heavy goods vehicles for using certain infrastructures such as motorways and multi-lane roads, bridges, tunnels and mountain passes. The Eurovignette is an electronic common toll collection system where a registered vehicle can pass through road tolls in Europe after paying a single fee related to its weight and size. In certain regions, extra toll charges may be levied to tackle the problem of environmental damage, including poor air quality, or to invest in more environmentally friendly modes of transport such as railways.

Many barriers to a single market began to be dismantled from the early 1990s on also via a succession of rules designed to standardise technical and administrative standards. These included rules to fix the maximum dimensions and weights of certain vehicles, the format of driving licences, vehicle registration documents and minimum driver training standards. It took many years for Member States to agree on working hours for road freight, which proved to be a particularly sensitive area, partly due to national differences in labour relations and working cultures. The EU now has common rules for maximum driving times, as well as minimum rest periods for all drivers of road haulage and passenger vehicles.

- *Maritime transport*

Maritime transport is of huge importance for European trade since almost 90 % of the European Union's external freight and 40 % of its internal freight is moved by the Sea. For many years, there was no EU-wide policy for maritime transport. It was only in 1986 that Europe was ready to adopt its first legislative package of regulations, which aimed primarily to open up its markets in maritime transport and services. A second package came in 1989, allowing maritime transport services within one EU country to be offered by companies of another EU country (cabotage). This helped to maintain adequate connections between islands and more remote maritime regions and the European mainland. Environmental issues are now an integral part of shipping legislation, as this is the case with the legislation applying to the other means of transport.

Access to the electricity grid and the usage of pipelines to which we turn now is not part of transportation policy, but of energy policy.

Access to the electricity grid[173]

One of the main aims of EU energy policy is to integrate national markets in order to create an EU internal energy market. To achieve this by 2014, the EU Commission had initiated three key legislative initiatives (the first, second and in 2009 the third Energy Market Package) and also set up the "regional initiatives for electricity and natural gas". The Energy Market Package sets the framework of rules on the one hand, while market participants and regulatory authorities work together on the regional initiatives. Despite these measures, significant differences between the energy markets of the member states remain up until today, although this applies more in the case of natural gas than of electricity.

To create competitive electricity and gas markets the EU considers that transmission system operators (TSO) need to act independently from immediate producer and trader interests. Consequently, the Third Energy Package provides for the unbundling of the TSOs, either by transferring ownership of the grids to an independent company (ownership unbundling) or by awarding grid operation to a company independent from the grid's owners (independent system operator – ISO) or by isolating of grid operations within an integrated company by organisational and legal means (independent transmission operator – ITO). Since 2012 many EU countries have implemented ownership unbundling for electricity grids, though many of them retain integrated structures.

The task of the TSO is to collect the electricity demand of the next day as announced by the suppliers of final customers and the production capacity offered by the producers for tomorrow on an hourly basis and to determine the production plan in accordance with marginal costs.[174] Since announced demand will not exactly match the pre-ordered capacity, the TSO calls also in reserve energy, the latter being regularly supplied drawing on the water in the basins constructed by hydroelectric power plants. Peak demand will often be covered by the combustion of natural gas, thus establishing a relevant link between natural gas and electricity (while initially, the gas market used to be handled as an annex of the oil market).

TSOs have a responsibility within their national markets, leading to the question of trade in electricity. If interconnection capacity falls short of the excess demand present in one region at a common price and the supply in the other region at this price, coupling has to be given up. Otherwise, market coupling is feasible. In 2014, a major achievement was a coupling in the sense that the TSOs of 14 countries in the north and northwestern part of Europe were integrated, i.e. the offer that may be covered (or sold) by imports (by exports) in the single national markets are incorporated into the establishment of the daily operation plans according to commonly established pricing rules. The less far reaching solution is that actors on the electricity market act not only simultaneously as purchasers in the market with excess supply at a common price and sellers in the other market but participate also in auctions of the interconnection capacity. In the case of market coupling, TSOs have to agree on where interconnection capacity should be used. In the case of auctioning interconnection capacity, EU regulation foresees that the proceeds of these auctions should be used to cover the costs of managing the bottlenecks, to finance capacity extension and to lower final customer prices. Financial incentives to maintain the bottlenecks should thereby be eliminated. Transparency on the utilisation of the proceeds of the auctions is low, however. The auctioning solution becomes controversial when the electricity is fuelled through a third country such as Switzerland: Shall the auctioning take place at the border of the market with excess supply, when it leaves the transit country or at the entry of the market with excess demand and how shall the proceeds of such auctioning be divided among the countries and the usages the EU regulation allows for?

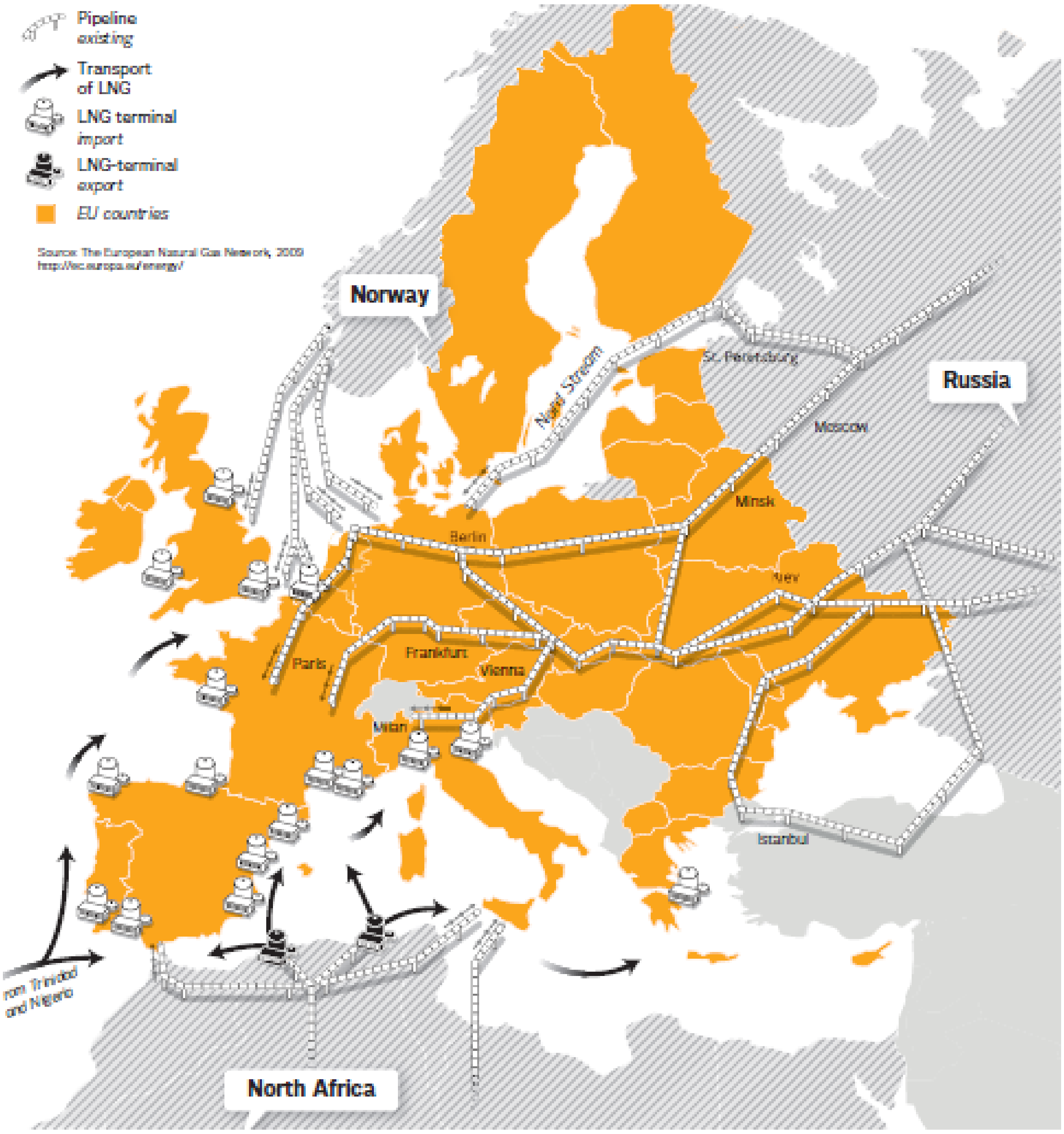
Finally, there is the option of merchant lines. i.e. investment in interconnection by private parties

[173] Text based on http://www.axpo.com/axpo/ch/en/konzern/axpo-in-europa/energy-markets.html

[174] Market manipulation can occur when a producer withdraws on dubious grounds ("unexpected service needs" a.s.o.) the capacity of an important plant in a moment when he knows that this plant has a significant effect on the marginal prices.

Import routes for natural gas to the EU

The illustration gives an overview over the import routes for natural gas to the EU. One quarter of all energy consumed within the EU is generated by gas, 60 per cent of which is imported from locations such as Russia, Norway and Algeria.



fully or partially exempted from the rules on Third Party Access and/or the rules on the use of the congestion rent. Merchant lines constitute a quandary, however. An obvious advantage of merchant lines[175] is that private parties also contribute to the overall development of interconnection, thereby enlarging markets. On the other hand, when these investments are undertaken by dominant market participants, a potential for harming competition (e.g. by manipulating the auctions at other interconnection points) exists. An example of a merchant line are the 4.4 km from the Swiss border at Campocologno to the Italian town of Tirano, where the merchant line meets the high tension line linking the hydroelectric power plants in the upper part of the Valtelline

[175] de Hauteclocque, Adrien and Vincent Rious (2914): Reconsidering the regulation of merchant transmission investment in the light of the third energy package: The role of dominant generators. European University Institute (EUI) Working Papers RSCAS 2009/59, Robert Schumann Centre for Advanced Studies

with their barrages and the major north Italian towns of Milano and Bergamo.

- *Access to gas pipelines*

The legal framework with, as ingredients, the constitution of TSOs, market coupling, auctioning of interconnection capacity and merchant lines applies not only to the electricity grid, but also to the network of pipelines for natural gas. Gas storage and liquefied natural gas (LNG) facilities are also covered. Regulations address access to infrastructures, particularly by determining the establishment of tariffs (solely for access to networks), services to be offered, allocation of capacity, transparency and balancing of the network. The situation in gas and electricity is not fully comparable, however.[176]

5 The Energy Charter

Energy cannot be sent through the air on a commercial basis and due to the high volumes involved, rail and road transportation, while important, are often superseded by energy specific transportation routes such as high tension lines and pipelines. The latter are however less well covered by the freedom of transit. This, beyond geo-strategic considerations (key-word: pipeline politics) conveys a particular interest to the Energy Charter although the Energy Charter has difficulties to live up to expectations.

The roots of the Energy Charter date back to a political initiative launched in Europe in the early 1990s, at a time when the end of the Cold War offered an unprecedented opportunity to overcome previous economic divisions. Nowhere were the prospects for mutually beneficial cooperation clearer than in the energy sector, and there was a recognised need to ensure that a commonly accepted foundation was established for developing energy cooperation among the states of Eurasia. Based on these considerations, the Energy Charter process was born with the 1991 Energy Charter, the 1994 Energy Charter Treaty and the 1998 Trade Amendment as landmarks.

The 1991 Energy Charter

The European Energy Charter provides the political foundation for the Charter process. The Charter is a concise expression of the principles that should underpin international energy cooperation, based on a shared interest in secure energy supply and sustainable economic development. This political declaration has been signed by fifty-four European countries (plus some 20 countries having signed the International Energy Charter, see below). All Charter signatories are observers to the Charter Process, and signing is a first and necessary step towards accession to the 1994 Energy Charter Treaty.

In recent years, the Organisation had been working on the globalisation of the charter. In May 2015, at a High-Level Ministerial Conference hosted by the Netherlands in The Hague the "International Energy Charter political declaration" was adopted. More than 70 countries and a number of international organisation are involved as members or observers in the Charter's conference, with the notable absence of the Russian Federation in the most recent evolutions.

The 1994 Energy Charter Treaty

The Energy Charter Treaty plays an important role as part of an international effort to build a legal foundation for energy security, based on the principles of open, competitive markets and sustainable development. To serve the latter, to the Energy Charter Treaty the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects was added. Both were signed in December 1994 and entered into legal force in April 1998. To date, the Treaty has been signed or acceded to by fifty-two states, the European Community and Euratom (the total number of its members is therefore fifty-four). The states that have signed but not ratified the treaty are Australia, Belarus (applying the treaty provisionally), Iceland and Norway. Crucially important, on 20 August 2009, the Russian Federation has officially informed the Depository that it did not intend to become a Contracting Party to the ECT. In accordance with Article 45(3(a)) of the Treaty, such notification resulted in Russia's termination of its provisional application of the ECT upon expiration of 60 calendar days from the date on which the notification was received by the Depository.

The Treaty's provisions focus on four broad areas:

- the protection of foreign investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable) and protection against key non-commercial risks;
- non-discriminatory conditions for trade in energy materials, products and energy-related equipment based on WTO rules, and provisions to ensure reliable cross-border

[176] Relevant is regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks, a text with EEA relevance (think of Norwegian gas fields). The business case to Chapter 10 in the underlying publication provides useful additional information.

energy transit flows through pipelines, grids and other means of transportation;

- the resolution of disputes between participating states, and - in the case of investments - between investors and host states;
- the promotion of energy efficiency, and attempts to minimise the environmental impact of energy production and use.

The 1994 Treaty is the only legally binding multilateral agreement covering the whole energy value chain (from exploration to end-use) and all energy products and energy-related equipment. Additionally, through the implementation of the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, the Energy Charter provides its member countries with a menu of good practices and a forum in which to share experiences and policy advice on energy efficiency issues. Within this forum, particular attention is paid to such aspects of a national energy efficiency strategy as taxation, pricing policy in the energy sector, environmentally-related subsidies and other mechanisms for financing energy efficiency objectives.

The 1998 Trade Amendment:

The Energy Charter Treaty's trade provisions, which were initially based on the trading regime of the GATT, were modified by the adoption in April 1998 of a Trade Amendment to the Treaty to bring the Treaty's trade provisions into line with the rules and practices of the World Trade Organisation. The shared principles underpinning both the Energy Charter Treaty's approach and that of the WTO are non-discrimination, transparency and a commitment to the progressive liberalisation of international trade. The Trade Amendment also expands the Treaty's scope to cover trade in energy-related equipment, and sets out a mechanism for introducing in future a legally-binding stand-still on customs duties and charges for energy-related imports and exports. The Treaty's amended trade regime represents an important stepping stone for those five of its Signatory states (Azerbaijan, Belarus, Bosnia & Herzegovina, Turkmenistan, Uzbekistan) which had not yet acceded to the WTO by the end of 2015.

Contentious topics

Areas where the Energy Charter tries to go beyond WTO-rules remain contentious. These are investment protection and a detailed regulation of the freedom of transit.

With regard to investment protection, it is noteworthy that the Treaty carries a legal force equivalent to a unified network of bilateral investment protection treaties. As is true with most investment protection agreements, in its present form, the Treaty obliges Contracting Parties to accord non-discriminatory treatment only to existing investments made by investors of other Contracting Parties. The adoption of a Supplementary Treaty that would extend this obligation to ensure non-discriminatory treatment also in the pre-investment phase (the so-called “Making of Investments” stage) remains under discussion among the Energy Charter’s member states.

To better secure the freedom of transit, the Charter’s participating states have looked to enhance the Treaty’s provisions on transit through the elaboration of a Transit Protocol, on which formal negotiations commenced in early 2000. This item remains under discussion. The Transit Protocol’s aim is to develop a regime of commonly accepted operative principles covering transit flows of energy resources, both hydrocarbons and electricity, crossing at least two national boundaries, designed to ensure the security and non-interruption of transit. Additionally, the Energy Charter Conference approved in 1998 a set of rules of procedure for the conduct of conciliation during disputes over matters of energy transit. The Conference also took positive note in 2003 of the first edition of Model Agreements on Cross-Border Pipelines, prepared based on a mandate from the Conference in 1999.

As a conclusion, one has to observe that it is particularly difficult to shield trade in energy from geopolitics. But, as argued on the Energy Charters homepage, in a world of increasing interdependence between net exporters of energy and net importers, multilateral rules can provide a more balanced and efficient framework for international cooperation than is offered by bilateral agreements alone or by non-legislative instruments. The energy charter process acts as a useful standard setter. States, when not complying, have to make the diplomatic effort to explain their different point of view and this comes at some political costs.

Chapter 10
Reconciling Free Trade and Environmental Protection

1 Overview of multilateral environmental agreements with trade relevance

The Committee on Trade and Environment of the World Trade Organisation has established a compendium on trade related measures pursuant to selected multilateral environmental agreements (MEA).[177] The following agreements are listed and briefly summarized in this document:

A. INTERNATIONAL PLANT PROTECTION CONVENTION (IPPC)

B. INTERNATIONAL CONVENTION FOR THE CONSERVATION OF ATLANTIC TUNAS (ICCAT)

C. CONVENTION ON INTERNATIONAL TRADE IN ENDANGERED SPECIES OF WILD FAUNA AND FLORA (CITES)

D. CONVENTION ON THE CONSERVATION OF ANTARCTIC MARINE LIVING RESOURCES (CCAMLR)

E. MONTREAL PROTOCOL ON SUBSTANCES THAT DEPLETE THE OZONE LAYER

F. BASEL CONVENTION ON THE CONTROL OF TRANSBOUNDARY MOVEMENTS OF HAZARDOUS WASTES AND THEIR DISPOSAL

G. CONVENTION ON BIOLOGICAL DIVERSITY (CBD)

H. CARTAGENA PROTOCOL ON BIOSAFETY TO THE CONVENTION ON BIOLOGICAL DIVERSITY

I. NAGOYA PROTOCOL ON ACCESS TO GENETIC RESOURCES AND THE FAIR AND EQUITABLE SHARING OF BENEFITS ARISING FROM THEIR UTILIZATION TO THE CONVENTION ON BIOLOGICAL DIVERSITY

J. NAGOYA – KUALA LUMPUR SUPPLEMENTARY PROTOCOL ON LIABILITY AND REDRESS TO THE CARTAGENA PROTOCOL ON BIOSAFETY

K. UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (UNFCCC)

L. KYOTO PROTOCOL TO THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE

M. INTERNATIONAL TROPICAL TIMBER AGREEMENT (ITTA)

N. THE UN FISH STOCKS AGREEMENT

O. ROTTERDAM CONVENTION ON THE PRIOR INFORMED CONSENT PROCEDURE FOR CERTAIN HAZARDOUS CHEMICALS AND PESTICIDES IN INTERNATIONAL TRADE

P. STOCKHOLM CONVENTION ON PERSISTENT ORGANIC POLLUTANTS

In a second step, for all these agreements, the trade relevant articles are reproduced in the document (plus a summary of trade relevant decisions by the bodies in charge of enacting these agreements). We concentrate here on the Basel Convention and present only an excerpt of what is considered as trade relevant by the WTO-committee. Notably, the following passages in Article 4 of the Basel Convention stand out:

2. Each Party shall take the appropriate measures to:

(a) Ensure that the generation of hazardous wastes and other wastes within it is reduced to a minimum, taking into account social, technological and economic aspects;

(b) Ensure the availability of adequate disposal facilities, for the environmentally sound management of hazardous wastes and other wastes, that shall be located, to the extent possible, within it, whatever the place of their disposal;

[177] See World Trade Organisation, Committee on Trade and Environment, Matrix on trade related measures pursuant to selected multilateral environmental agreements, 4 October 2013 (WT/CTE/W/160/rev.6).

…

(d) Ensure that the trans-boundary movement of hazardous wastes and other wastes is reduced to the minimum consistent with the environmentally sound and efficient management of such wastes, and is conducted in a manner which will protect human health and the environment against the adverse effects which may result from such movement;

(e) Not allow the export of hazardous wastes or other wastes to a State …, particularly developing countries, which have prohibited by their legislation all imports, or if it has reason to believe that the wastes in question will not be managed in an environmentally sound manner, … .

5. A Party shall not permit hazardous wastes or other wastes to be exported to a non-Party or to be imported from a non-Party.

Furthermore, the control mechanism as laid down in para (1) of Article 4 is trade relevant:

1. (a) Parties exercising their right to prohibit the import of hazardous wastes or other wastes for disposal shall inform the other Parties of their decision pursuant to Article 13.

(b) Parties shall prohibit or shall not permit the export of hazardous wastes and other wastes to the Parties which have prohibited the import of such wastes, when notified pursuant to subparagraph (a) above.

(c) Parties shall prohibit or shall not permit the export of hazardous wastes and other wastes if the State of import does not consent in writing to the specific import, in the case where that State of import has not prohibited the import of such wastes.

In addition, the Basel Convention contains lists of what is considered as hazardous waste and allows for national extensions of these lists, making the latter also enforceable in the sense that an export permit is needed. Furthermore, the agreement foresees that national legislation provides for sanctions when the rules laid down in the Convention are infringed and it stipulates an obligation to re-import all waste exported in contravention to the agreement.

It is evident that the thrust of the Basel Convention goes in the opposite direction to the WTO with the idea that hazardous waste should be treated first within national borders and only exported under specific circumstances requiring consent of the import, export and transit countries. Against this background, it is somewhat astonishing that out of the 175 countries member of the Basel Convention, 139 are at the same members of the WTO. A need to reconcile eventual conflicting obligations thus not only arises within national administrations. It appears also that at the global level a common understanding regarding how WTO and MEAs interact should develop. Indeed, prior to the Doha Ministerial Conference, a number of proposals were made, among them also the idea of amending GATT Article XX. Based on these discussions, a "Singapore consensus" emerged.

The following summarizes its main elements: [178]

1. *The WTO supports multilateral solutions to global and trans-boundary environmental problems. Unilateral actions should be avoided;*
2. *Trade restrictions are not the only nor necessarily the most effective policy instrument to use in MEAs, but in certain cases they can play an important role;*
3. *The WTO provides broad and valuable scope for trade measures to be applied pursuant to MEAs in a WTO-consistent manner. There is no agreement for the time being that there is any need to change WTO provisions to provide increased coordination in this area;*
4. *To date, few MEAs contain trade provisions and no problem has arisen in the WTO over the use of trade measures applied pursuant to MEAs;*
5. *Better policy coordination can help prevent WTO disputes arising over the use of trade measures applied pursuant to MEAs;*
6. *Problems are unlikely to arise in the WTO over trade measures agreed and applied amongst Parties to an MEA; In the negotiation of a future MEA, particular care should be taken over how trade measures may be considered for application to non-parties;*
7. *WTO Members are confident that the WTO dispute settlement provisions are satisfactory to tackle any problems which arise in this area, including in cases where resort to environmental expertise is needed.*

As a matter of fact, WTO Members have not resorted to WTO dispute settlement with a view to

[178] World Trade Organisation, Committee on Trade and the Environment (1996): Report to the Singapore Ministerial Conference (WT/CTE/1). The quote is from TN/TE/S/1 of 23 May 2002

undermining the obligations they accepted by becoming Parties to an MEA, and the CTE considers that this will remain the case. Indeed, the Secretariat of the Basel Convention can only list a few decisions constituting the case law relevant to Article XX GATT, paragraphs (b), (d), and (g).[179] However, it should be remembered that these agreements oblige nations against each other. The agreements can usually not directly be invoked by individuals in national courts. As, additionally, national legislation transposing these international agreements is usually not very detailed, national administrations hold a considerable discretionary power in according priority to either trade or environmental concerns.

2 Unilateral Measures: Export Restrictions

WTO regulations affecting member-states ability to restrict exports are limited. Essential is Article XI GATT which requires members to eliminate all prohibitions and quantitative restrictions on exports. This article does not restrict Members in imposing duties, taxes or other charges on exports, however. An exception are new WTO Members, such as China, Mongolia, Saudi Arabia, and Ukraine, which were obliged to phase out export taxes or to limit them to a designated number of tariff lines with a bound rate, this as an additional concession they had to make to become a Member of the WTO.

Export prohibitions, quotas and tariffs (in the case of the countries that had when acceding also to bind export duties) may eventually be justified under Article XX GATT. This attempt was also made by China when alleged that the country's limitations of exports of rare earth elements do not respect WTO law.[180] With respect to the export quotas imposed, where paragraph (g) of Article XX GATT applies, China had to demonstrate that its measures satisfy the requirement of 'relating to' the conservation of natural (exhaustible) resources, that the measures operate 'in conjunction with restrictions on domestic production or consumption,' ('even-handedness requirement') and that its measures do not constitute 'a disguised restriction on international trade' ('chapeau' of Article XX). In a panel on Canadian fish export restrictions and a panel on former Chinese measures limiting other raw material exports, the Dispute Settlement Body (DSG) of the WTO had already examined the meaning of the terms 'relating to' and 'in conjunction with' as stated in Article XX(g).

Not surprisingly, the Panel held that "conservation" does not allow Members to adopt measures to control the international market for a natural resource, which is what the challenged export quotas were, in the view of the Panel, designed to do (see the 'chapeau' of Article XX). Additionally, the Panel examined the various domestic measures that China claimed restricted domestic access but found that the challenged export quotas do not work together with measures restricting domestic Chinese use of rare earths, tungsten, and molybdenum, as required by the second part of Article XX(g). The panel also rejected that the export duties on tariff lines not protected by the Accession Protocol could be justified under Article XX(b). China had argued that they are necessary to protect human, animal and plant life and health from the pollution caused by extraction. Finally, the panel found that China had not satisfactorily explained why its trading rights restrictions were justified under Article XX. The Appellate Body essentially upheld the findings of the panel and at its meeting on 29 August 2014, the DSB adopted the Appellate Body report and the panel report. On 8 December 2014, China and the United States informed the DSB that they had agreed that the reasonable period of time for China to implement the DSB recommendations and rulings shall expire on 2 May 2015.

Comment

While relevant articles of the GATT/WTO agreement mention imports and exports often in a symmetric way, it needs to be kept in mind that the GATT/WTO agreement stipulates obligations for nations. As long as countries run down their stocks of natural resources by absorption (i.e. production in the country for the final needs of the country) it is difficult to apply a regulatory on trade in order to get equal access to these resource stocks. The picture changes when the country exports intermediates or final goods using national resource stocks. Then, biased competition on downstream markets can be a reason to bring export restricting measures to the Dispute Settlement Body. Interests on the output side of com-

[179] See: http://www.basel.int/Implementation/LegalMatters/TradeandEnvironment/CaseLaw/tabid/3511/Default.aspx

[180] See https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds431_e.htm . Contested were over 30 measures including export duties, export quotas, minimum export price requirements, export licensing requirements and additional requirements and procedures in connection with the administration of the quantitative restrictions, affecting more than 200 eight-digit Chinese Customs Commodity Codes.

panies dominate over those on the input side, reflecting a mercantilist attitude of trade negotiators.

In an era where access to raw materials becomes more and more disputed, binding export tariffs and 'tariffication' of measures with similar effect should continue to rank high on the agenda of the WTO, despite the setbacks in the Doha-Round.[181] To seek compensation for commitments not obtained within the WTO in free trade agreements may be considered by import dependent nations. However, as enforcement mechanisms do not compare with those in the WTO, it is not worth paying in negotiations for a FTA a high price for the inclusion of rules restricting export taxes and quotas. In the very moment when such rules become relevant, the exporting country will normally be in a position to invoke a safeguard clause. Besides, in negotiations of FTAs, Switzerland hardly ever succeeded in laying down disciplines on exports whenever the other contracting party disposed of substantial natural resource stocks.

With regard to the DSB, it appears that it emphasises the need for a rule based international trade system when faced with indications that measures promote geo-strategic goals or reflect industrial policy. Consequently the DSB is inclined to view in such situations environmental aspects, when invoked, as a pretext. Stated differently, to promote an environmental goal does not heal all measures. This priority ranking is reasonable since the motive to leave to future generations an adequate bequest of exhaustible natural resources as well as the aspect of negative environmental externalities of extraction activities, while justifying government interventions, can most of the time be handled by other measures in a non-trade distorting way, and often better.

3 Unilateral Measures: Import Bans

As indicated above, Article XX of the GATT allows countries to adopt policy measures that are inconsistent with GATT disciplines, but necessary to protect human, animal or plant life or health (paragraph (b)), or relating to the conservation of exhaustible natural resources (paragraph (g)), under the proviso of the "chapeau" of Article XX, i.e. that the measures are not applied in a manner which would constitute "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail", and is not "a disguised restriction on international trade". Cases of import bans added additional insight into the handling of these provisions.

To determine whether a measure is "necessary" to protect human, animal or plant life or health under Article XX(b), a process of weighing and balancing of a series of factors has been used by the Appellate Body. It examined inter alia the contribution made by the environmental measure to the policy objective, the importance of the common interests or values protected by the measure and the impact of the measure on international trade. With regard to the promotion of recycling, the Brazil Tyres case of 2007 is of interest.[182] Here, the Appellate Body found that the import ban on retreaded tyres was "apt to produce a material contribution to the achievement of its objective", i.e. the reduction in waste tyre volumes. The Appellate Body also doubted whether the proposed alternatives, which were mostly remedial in nature (i.e. waste management and disposal), were real alternatives to the import ban, which could prevent the accumulation of tyres.[183] When examining this point, the Appellate Body found that the test regarding 'necessity' needs to consider the capacity of a country so as to ensure that measures do not impose "an undue burden" such as "prohibitive costs or substantial technical difficulties", i.e. the ruling acknowledges that the meaning of "an undue burden" must be determined with reference to the degree of the development of a country. Brazil lost the case, however. The reason was that Brazil had been obliged by a MERCOSUR ruling to allow imports of retreaded tires from Mercosur countries. Brazil reacted to the WTO ruling by applying the import ban more strictly, i.e. by reducing world trade volume.

The three rulings of the DSB listed on the WTO homepage under the heading 'environmental disputes in GATT/WTO'[184] are also informative. In a case brought by Canada against the European Communities in 2001 with respect to asbestos, the DSB accepted that a different potential to affect human health makes similar products 'unlike', so that different measures may be applied to products serving a same purpose. In a case

[181] Corresponding initiatives had e.g. been launched by Japan and Switzerland.

[182] See inter alia: International Centre for Trade and Sustainable Development Information Note No.1 of September 2010: Litigating Environmental Protection and Public Health at the WTO: The Brazil Retreaded Tyres Case, retrievable at *www10.iadb.org/intal/intalcdi/pe/2010/06685.pdf*

[183] *To be characterised as necessary, a measure does not have to be indispensable. However, its contribution to the achievement of the objective must be material, not merely marginal or insignificant, especially if the measure at issue is as trade restrictive as an import ban.*

[184] https://www.wto.org/english/tratop_e/envir_e/edis00_e.htm

brought by India, Malaysia and Thailand against the USA, the USA were allowed to ban the import of shrimps if not fished by using nets that allow sea turtles to escape; the US lost the case due to the fact that some countries were financially supported in acquiring the nets, others not. NGOs were allowed to hand in "amicus curiae' submissions. The US lost a case against Venezuela and Brazil not because the country stipulated very high standards for gasoline in order to protect the environment, but because domestic producers had not to conform to equally high standards.

4 Unilateral Measures: Compensatory Border Measures

Global warming may be seen as the most delicate nexus between globalisation with its growth effects and the environment. This makes the question whether it is admissible for countries to take compensatory measures on imports from countries refraining to contribute to contain global emissions of green-house gases by appropriate measures particularly interesting. The question of compensatory border measures was addressed in a paper commonly released in 2009 by UNEP and WTO on "Trade and Climate Change" on which we draw here.[185]

Two concerns need to be addressed: The potential impact of climate change mitigation policies on production costs and thereby on the international competitiveness of countries, and, secondly, the issue of "carbon leakage", i.e. the risk of energy-intensive industries relocating to countries with weaker environmental policies. When examining these points it is important to keep in mind that tax exemptions and rebates based on the CO_2 intensity of output were granted to certain industries on a large scale, and that in the context of emission trading, a free allocation of emission allowances to energy-intensive industries occurred frequently. This attenuates the problem of reduced competitiveness and carbon leakage considerable while creating problems of its own when designing border compensation measures.

The case of compensatory border measures is more easily handled in the case of domestic taxes on CO_2 emissions. Border tax adjustments are commonly used with respect to domestic taxes on the sale or consumption of goods. Countries also commonly adjust domestic taxes on fossil fuels when importing such fuels. Problems arise since such measures would be imposed not only on imports of fuels, where they actually are, but also on especially energy-intensive imported products, depending from where they originate. The main difficulty in assessing products' emissions comes from the fact that greenhouse gas emissions involved in the production process may vary depending on the product, the company and the country.[186] An additional difficulty may arise in cases where imported products are subject, in the country of origin, to other climate change regulations, such as technical regulations, rather than price mechanisms such as taxes. Compliance with certain regulations, such as a fuel efficiency standard, may also involve a cost (e.g. investment in more energy-efficient technologies) that may be complex to evaluate and transform into an adjustable price or a "comparable action".

In the GATT Superfund case of 1987,[187] the panel found that a United States tax on certain chemicals that was imposed directly on products was eligible for border tax adjustment and consistent with GATT Article III.2. Importers were required to provide sufficient information regarding the chemical inputs of taxable substances to enable the tax authorities to determine the amount of BTA to be imposed. In cases where industries are not in a position to disclose any such information, the second option that has been suggested is for the country imposing the adjustment to assume that the imported products have been produced using the "best available technology" versus the average technology.

While border adjustment in the case of a carbon/energy tax can rely on the legally fixed tax rate(s), in the context of an emission trading scheme the border measure should in principle react to the fluctuations of the carbon price (or allowance price) the domestic industries face in order not to unduly protect them. Such discrimination – in either sense - may also arise in function of the exemptions and grandfather rights that were accorded to domestic industries and to the industries in the country from where the products subject to compensatory border measures originate. It makes things not easier that, in reality, a single firm might hold different types of allowances: some received free of charge, some purchased from the government in an auction, and others purchased on the open market. Therefore, it may be difficult to base a border adjustment on the current market price of allowances, especially when some free allocations have been distributed. In response to this problem, academics have also discussed the possibility of raising a countervailing duty (against "de facto subsidies")

[185] https://www.wto.org/english/res_e/booksp.../trade_climate_change_e.pdf

[186] CO_2 emissions linked to the heating and cooling of buildings depend on the latitude, e.g..

[187] See http://www.worldtradelaw.net/document.php?id=reports/gattpanels/superfund.pdf

or an anti-dumping duty (against "environmental dumping") on imported goods produced in countries that do not impose climate change related regulations. It should be noted however that if free allowances are found to be actionable subsidies covered by the Agreement on Subsidies and Countervailing Measures, "adverse effects" would have to be demonstrated for action to be taken by another WTO member.

Finally, it has been argued that carbon and energy taxes fall under the disciplines established with regard to technical barriers to trade. In general, it is highly contested whether products may be considered "unlike" because of differences in the way in which they have been produced (referred to as non-product-related processes and production methods (PPMs)), even though the production method used does not leave a trace in the final product, i.e. even if the physical characteristics of the final product remain identical. Against this opinion one may refer to the Superfund Case (which was ruled before the WTO was constituted, however). The problem of NTMs (Non-Tariff Barriers to Trade), a wider notion than TBTs (Technical Obstacles to Trade) deserves consideration, however. The administrative burden going along with the application of compensatory border measures increases with the complexity of the domestic rules which themselves are heavily influenced by the lobbies fighting for tax exemptions, grandfathering a.s.o.. It is doubtful to give these interest groups additional protection by way of the administrative burden the difficultly administrable compensatory border measures place on their foreign competitors.

A final reflection, not figuring in the UNEP/WTO document, is that 'carbon leakage' is not necessarily an evil. It holds true that global warming is not dependent on where on earth CO_2 is emitted in the atmosphere. For this reason, it is adequate that the final customer has to pay the duty. However, a series of CO_2 measures are adopted in order to fight local air pollution, or the latter may influence the tax rate applied or the price paid for allowances. From an environmental point of view, if imports from countries not suffering from the same amount of local air pollution problems are subject to a compensatory border measure, measures needed to fight local problems have to be more stringent. From a legal point of view, as long as CO_2 emission rights are not allocated by a global framework, countries hosting exporters exposed to compensatory border measures might argue with some chance that the imposing country is fighting a local problem and that the compensatory border measure are not warranted since the emissions have taken place in a cheese-bell less affected by air pollution.

Also in reaction to this last point, it rests to say that we omitted here all the reflections relating to an eventual justification (or critique by affected countries) of compensatory border measures by way of Article XX GATT/WTO. Corresponding indications may be found in the two preceding sections.

5 The outcome of COP 21

For a long time, it proved difficult to conclude an agreement for the period after the expiration of the Kyoto Protocol which occurred in 2012. Industrialised nations insisted on the requirement that emerging economies would also have to observe quantitative targets. The developing countries could respond that, for equity reasons, they should be entitled to reach in their development similar per capita CO_2-emissions as the industrialised world. Given the need to act on the local level and considering the impact their GDP exercises on global CO_2 emissions, emerging countries showed eventually also some readiness to accept limits on their emissions of green-house gases provided they obtain compensation in the sense that the industrialised nations come up for a substantial part of the extra investment needed to bring down the CO_2-emission coefficient of economic output. There are three possibilities open to developed nations to operate this transfer. One possibility is to transfer money from the government. A second possibility is to transfer technology. And a third possibility is to make emission rights internationally tradable, conditional on the aspect that transparency regarding efforts undertaken and quantities traded may be achieved.[188] Evidently, the three options do not exclude each other, and one option may be used to support the other. The agreement concluded at the 21st conference of the contracting parties (COP21) in Paris in December 2015 addresses all three possibilities, but core is that many emerging economies now also declared their readiness to respect quantitative targets.

The table on the next page shows in the last column the commitments made by the largest emitters of CO_2 on a per country basis. They are quasi identical with the G20 countries, the latter accounting for well above 90% of world GDP. So these are the commitments that really matter, first of all those of China and the US.

[188] Often moral standards are advanced against trading emission rights. This may in the end be disguised protectionism, supported by the lobby which benefits if abatement and mitigation measures are put in place locally, although at (usually significantly) higher costs. Efficient control mechanisms can also be put in place abroad so that this objection is not really valid.

CO2 emissions of the major countries and their commitments according to COP21

		Ktons (country level)	tons (per capita)	major commitment
	World	35,669,000	5.0	
1.	China	10,540,000	7.6	A peak in carbon dioxide emissions by 2030, with “best efforts” to peak earlier. China has also pledged to source 20% of its energy from low-carbon sources by 2030 and to cut emissions per unit of GDP by 60-65% of 2005 levels by 2030, potentially putting it on course to peak by 2027
2.	United States	5,334,000	16.5	26-28% domestic reduction in greenhouse gases by 2025 compared to 2005, making its “best effort” to reach the 28% target. This includes the land sector and excludes international credits “at this time”.
3.	European Union	3,415,000	6.7	At least a 40% domestic reduction in greenhouse gases by 2030 compared to 1990 levels
4.	India	2,341,000	1.8	A 33-35% reduction in emissions intensity by 2030, compared to 2005 levels. Will also increase tree cover.
5.	Russia	1,766,000	12.4	25-30% domestic reduction in greenhouse gases by 2030 compared to 1990 levels
6.	Japan	1,278,000	10.1	A 26% reduction in emissions on 2013 levels by 2030
7.	Iran*	618,000	7.9	A 4% cut in emissions by 2030 relative to business as usual, or a 12% cut conditional on international support of $35bio.
8.	South Korea	610,000	12.3	A 37% reduction on business-as-usual emissions by 2030
9.	Canada	565,000	15.9	A 30% reduction on 2005 greenhouse gas emissions, by 2030. This includes possible use of international emissions credits. It also includes the land sector and forestry
10.	Brazil	501,000	2.5	A 37% reduction in emissions by 2025, compared to 2005 levels, with a further indicative target of a 43% reduction in emissions by 2030
11.	Saudi Arabia	494,000	16.8	Investent in renewable energy and economic diversification shall lead to savings of up to 130 million tonnes of CO2 equivalent in 2030 relative to business as usual
12.	Mexico	456,000	3.7	Unconditional 25% reduction in greenhouse gases and short lived climate pollutants from a business-as-usual scenario by 2030. This means peaking net emissions by 2026 and reducing emissions intensity per unit of GDP sharply.
13.	Indonesia	452,000	1.8	A 29% reduction in emissions by 2030, compared to business as usual. Indonesia says it will increase its reduction goal to 41%, conditional on “support
14.	Australia	409,000	17.3	A 26 to 28% reduction in emissions by 2030 on 2005 levels
15.	South Africa	392,000	7.4	Aims to peak between 2020 and 2025 (initial reference value not clear) , plateau for roughly a decade and then start to fall.
16.	Turkey	353,000	4.7	A 21% reduction in emissions by 2030, compared to a business-as-usual scenario. Requests financial support

International Shipping adds 624,000 Ktons and International Aviation 492,000 Ktons. While Iran is not a G20 country, the G20 country missing, namely Argentina, emits 199,043 Ktons or 4.8t on a per capita basis. Switzerland emits 40,229 Ktons or 4.9t on a per capita basis.

Source for emissions: EDGAR database created by European Commission and Netherlands Environmental Assessment Agency as released in 2014. Source for commitments: http://www.carbonbrief.org/paris-2015-tracking-country-climate-pledges

The wide range of per capita CO_2 emissions stands out. Some of the differences are attributable to the CO_2 released in the process of drilling oil and gas, and this burden for the environment should at least partially be put on the shoulders of the net importers of fossil fuels, at least to the extent that these leakages cannot technologically be avoided. This qualification made, the wide range of per capita values still indicates the broad spectrum of possibilities available to produce national income with a reduced output of greenhouse gases.

Chapter 11
Core Labour Standards

1. The content of the Core Labour Standards
2 Supervising ILO-Conventions – the case of Morocco

The International Labour Organisation (ILO), a Geneva based International Organisation, where representatives of governments, employers and workers meet, emits *conventions*, which are legally binding international treaties that need to be ratified by member states, and *recommendations.* The latter often provide more detailed guidelines on how conventions should be applied. Representation and complaint procedures can be initiated against countries for violations of a convention they have ratified. Furthermore, the organisation deploys substantive supervisory activities as part of its regular work programme.

The ILO's Governing Body has identified eight ILO conventions as "fundamental", covering subjects that are considered as basic principles and rights at work, namely: freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labour; the effective abolition of child labour; and the elimination of discrimination in respect of employment and occupation. These principles are also covered in the ILO Declaration on Fundamental Principles and Rights at Work (1998).[189] In 1995, the ILO launched a campaign to achieve universal ratification of these eight conventions. There are currently over 1,200 ratifications of these conventions, representing 86% of the possible number of ratifications. The following table indicates how many countries have ratified the eight core labour market conventions and when Morocco, the country of interest in the corresponding chapter of the underlying publication, and Switzerland have ratified these conventions.

Country	Freedom of association		Forced labour		Discrimination		Child labour	
	C087	C098	C029	C105	C100	C111	C138	C182
Total: 185	**152**	**163**	**177**	**174**	**171**	**172**	**166**	**177**
Morocco		1957	1957	1966	1979	1963	2000	2001
Switzerland	1975	1999	1940	1958	1972	1961	1999	2000

As can be seen, Morocco has not yet ratified the Convention concerning Freedom of Association and Protection of the Right to Organize which entered into force in July 1950.

ILO's Governing Body has also designated another four conventions as "priority" instruments due to their importance for the functioning of the international labour standards system, namely the Labour Inspection Convention of 1947 (No. 81), the Employment Policy Convention of 1964 (No. 122), the Labour Inspection Convention regarding the Agricultural Sector of 1969 (No. 129) and the Tripartite Consultation Convention of 1976 (No. 144).

1 Content of the Core Labour Standards

The ***Freedom of Association and Protection of the Right to Organise Convention (C087)*** stipulates that workers and employers, without distinction whatsoever, shall have the right to establish and, subject only to the rules of the organisation concerned, to join organisations of

[189] see http://www.ilo.org/declaration/lang--en/index.htm

their own choosing without previous authorisation. These organisations shall have the right to draw up their constitutions and rules, to elect their representatives in full freedom, to organise their administration and activities and to formulate their programmes. The public authorities shall refrain from any interference (e.g. to dissolve or suspend an organisation). Federations and confederations of workers' and employers' organisations have the same rights. While they shall respect the law of the land, the law of the land shall not be such as to impair, nor shall it be so applied as to impair, the guarantees provided for in this Convention. Special legislation may concern the military and the police. The binding period renews for ten years.

The ***Convention concerning the Application of the Principles of the Right to Organise and to Bargain Collectively (C098)*** stipulates i.a. that workers shall enjoy adequate protection against acts of anti-union discrimination in respect of their employment. Such protection shall apply more particularly in respect of acts calculated to (a) make the employment of a worker subject to the condition that he shall not join a union or shall relinquish trade union membership; b) cause the dismissal of or otherwise prejudice a worker by reason of union membership or because of participation in union activities outside working hours or, with the consent of the employer, within working hours. Acts which are designed to promote the establishment of workers' organisations under the domination of employers or employers' organisations, or to support workers' organisations by financial or other means, with the object of placing such organisations under the control of employers or employers' organisations, shall be deemed to constitute acts of interference within the meaning of the convention. The latter further requires that measures appropriate to national conditions shall be taken, where necessary, to encourage and promote the full development and utilisation of machinery for voluntary negotiation between employers or employers' organisations and workers' organisations, with a view to the regulation of terms and conditions of employment by means of collective agreements. The convention does not deal with the position of public servants engaged in the administration of the State.

The ***Convention concerning Forced or Compulsory Labour (C029)*** first clarifies that for the purposes of this Convention the term ‘forced or compulsory labour‘ shall mean all work or service which is exacted from any person under the menace of any penalty and for which the said person has not offered himself voluntarily. It then goes on: the term ‘forced or compulsory labour‘ shall not include (a) any work or service exacted in virtue of compulsory military service laws for work of a purely military character; b) any work or service which forms part of the normal civic obligations of the citizens of a fully self-governing country; (c) any work or service exacted from any person as a consequence of a conviction in a court of law, provided that the said work or service is carried out under the supervision and control of a public authority and that the said person is not hired to or placed at the disposal of private individuals, companies or associations; (d) any work or service exacted in cases of emergency, that is to say, in the event of war or of a calamity or threatening calamity, such as fire, flood, famine, earthquake, violent epidemic or epizootic diseases, invasion by animal, insect or vegetable pests, and in general any circumstance that would endanger the existence or the well-being of the whole or part of the population; (e) minor communal services of a kind which, being performed by the members of the community in the direct interest of the said community, can therefore be considered as normal civic obligations incumbent upon the members of the community, provided that the members of the community or their direct representatives shall have the right to be consulted in regard to the need for such services. The convention then has some safeguard measures so that exemptions a) to e) do not open too many doors for forced labour. E.g., only adult able-bodied males who are of an apparent age of not less than 18 and not more than 45 years may be called upon for forced or compulsory labour after a medical check and in respect for conjugal and family ties. Also, the maximum period for which any person may be taken for forced or compulsory labour of all kinds in any one period of twelve months shall not exceed sixty days and a certificate shall indicate the periods of such labour which he has completed. The normal working hours of any person from whom forced or compulsory labour is exacted shall be the same as those prevailing in the case of voluntary labour, and the hours worked in excess of the normal working hours shall be remunerated at the rates prevailing in the case of overtime for voluntary labour and paid out individually. Furthermore, a weekly day of rest shall be granted to all persons from whom forced or compulsory labour of any kind is exacted. Furthermore, the convention stipulates rules regarding working conditions and social protection.

The ***Convention concerning the Abolition of Forced Labour (C105)*** obliges members to suppress and not to make use of any form of forced or compulsory labour (a) as a means of political coercion or education or as a punishment for holding or expressing political views or views ideologically opposed to the established political, social or economic system; (b) as a method of mobilising and using labour for purposes of economic development; (c) as a means of labour discipline; (d) as a punishment for having participated in strikes; (e) as a means of racial, social, national or religious discrimination.

The ***Convention concerning Minimum Age for Admission to Employment (C138)*** lays down that the minimum age for admission to employment shall not be less than the age of completion of compulsory schooling and, in any case, shall not be less than 15 years. Member whose economy and educational facilities are insufficiently developed may, after consultation with the organisations of employers and workers concerned, where such exist, initially specify a minimum age of 14 years. Work which by its nature or the circumstances in which it is carried out is likely to jeopardise the health, safety or morals of young persons shall not be performed by persons less than 18 years. The provisions of the Convention shall be applicable as a minimum to the following sectors: mining and quarrying; manufacturing; construction; electricity, gas and water; sanitary services; transport, storage and communication; and plantations and other agricultural undertakings mainly producing for commercial purposes, but excluding family and small-scale holdings producing for local consumption and not regularly employing hired workers. This Convention does not apply to work done by children and young persons in schools for general, vocational or technical education or in other training institutions, or to work done by persons at least 14 years of age in undertakings where such work is carried out in accordance with conditions prescribed by the competent authority, and is an integral part of a course of education or training for which a school or training institution is primarily responsible. Furthermore, national laws or regulations may permit the employment or work of persons 13 to 15 years of age on light work which is not likely to be harmful to their health or development; and not such as to prejudice their attendance at school, their participation in vocational orientation or training programmes approved by the competent authority or their capacity to benefit from the instruction received.

The ***Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour (C182)*** specifies that the term ‘the worst forms of child labour’ comprises: (a) all forms of slavery or practices similar to slavery, such as the sale and trafficking of children, debt bondage and serfdom and forced or compulsory labour, including forced or compulsory recruitment of children for use in armed conflict; (b) the use, procuring or offering of a child for prostitution, for the production of pornography or for pornographic performances; (c) the use, procuring or offering of a child for illicit activities, in particular for the production and trafficking of drugs as defined in the relevant international treaties; (d) work which, by its nature or the circumstances in which it is carried out, is likely to harm the health, safety or morals of children.

The ***Equal Remuneration Convention (C100)*** requires that each Member shall, by means appropriate to the methods in operation for determining rates of remuneration, promote and, in so far as is consistent with such methods, ensure the application to all workers of the principle of equal remuneration for men and women workers for work of equal value. This principle may be applied by means of (a) national laws or regulations; (b) legally established or recognised machinery for wage determination; (c) collective agreements between employers and workers; or (d) a combination of these various means. It encourages the adoption of measures to promote an objective appraisal of jobs on the basis of the work to be performed.

The ***Convention concerning Discrimination in Respect of Employment and Occupation (C111)*** declares that the term discrimination includes (a) any distinction, exclusion or preference made on the basis of race, colour, sex, religion, political opinion, national extraction or social origin, which has the effect of nullifying or impairing equality of opportunity or treatment in employment or occupation; (b) such other distinction, exclusion or preference which has the effect of nullifying or impairing equality of opportunity or treatment in employment or occupation as may be determined by the Member concerned after consultation with representative employers' and workers' organisations, where such exist, and with other appropriate bodies. It goes on stating that any distinction, exclusion or preference in respect of a particular job based on the inherent requirements thereof shall not be deemed to be discrimination. Member states have to declare and pursue a national policy designed to promote, by methods appropriate to national conditions and practice, equality of opportunity and treatment in respect of employment and occupation, with a view to eliminating any discrimination in respect thereof.

2 Supervising ILO-Conventions

A strength of the International Labour Organisation is that a standing committee supervises the respect of the conventions on an annual basis, that international organisations of workers (and employers) can articulate concerns on behalf of their national members who may have political difficulties to speak up, and that information about contentious situations is made publicly available.[190] The reports of the Committee of Experts on the Application of Conventions and Recommendations (CEACR)[191] contain indeed pointed observations and recommendations to a wide area of topics, and what one can read will often not please the governments.

Based on a choice motivated in the underlying publication, Morocco is here chosen as an example. In the case of Morocco, in the years 2011 to 2015, observations were made on the application of the six core conventions C029, C100, C105, C111, C138, C182 (recall that Morocco has only ratified one of the two freedom of association conventions, namely C098 but not C087, limiting the CEACR in this area). Of the other conventions, C081, C094, C129 and C122 gave rise to remarks in the CEACR reports. Direct requests to the national government were addressed by the CEACR on the application of conventions C002, C004, C013, C017, C019, C029, C030, C042, C055, C081, C098, C100, C105, C111, C119, C122, C129, C136 C138, C144, C145, C147, C150, C154, C158, C162, C181 and C182, testifying of an immense workload managed by the Committee which has to look also at 185 other member states.

Here we will resume the remarks the Committee made in the case of Morocco with regard to the six core conventions mentioned above.[192] Through the remarks, it becomes also apparent that the ILO has been providing since the early 1950s technical cooperation to countries on all continents and at all stages of economic development. Projects are implemented through close cooperation between recipient countries, donors, and the ILO, which maintains a network of area and regional offices worldwide.

Forced labour

In 2011, the Committee took up the Forced Labour Convention (C029). It noted that in Morocco several legislative texts authorize the requisitioning of persons and of goods in order to satisfy national needs and that these go beyond what is authorized under Article 2(2)(d) of the Convention. In spite of the fact that in practice the public authorities do not appear to make use of these provisions for the requisitioning of persons, the Committee asked to modify these provisions. It expressed also its reservations concerning the dissuasive nature of the penalties set out in section 12 of the Labour Code against persons requisitioning employees to perform forced labour or to work against their will. Since the sanction corresponds to the highest level of penalties established by the Moroccan Labour Code, the Committee suggested criminalizing forced labour in the Penal Code.

In 2013, the Committee reiterated the remarks made regarding the Forced Labour Convention (C029) with respect to requisitioning of persons and effective and strictly applied penal sanctions in the case of infractions and then took up the Abolition of Forced Labour Convention (C105). The latter prohibits the imposition of prison sentences involving the obligation to work as punishment for expressing political views, and this was an opportunity to point to the delicate situation in the country with respect to the freedom of the press. The Committee formulated the hope that, within the framework of the adoption of a new Press Code, persons who express political views or views ideologically opposed to the established political, social or economic system in the press cannot be punished with a sentence of imprisonment involving compulsory labour. It requested the Government to provide a copy of the new Press Code, once adopted. With regard to the application in practice of section 179 of the Penal Code, which establishes a penalty of imprisonment and a fine for any offence against the King, the heir to the throne or members of the royal family, the Committee observed that those committing such offences were in practice prosecuted under section 41 of the Press Code.

Article 1(d) of C029 addresses the imposition of prison sentences involving an obligation to work as punishment for having participated in strikes. In its previous comments, the Committee had taken note of the information illustrating the scope given by the courts to the provisions of section 288 of the Penal Code. Under the terms of this section, any person who, through the use of violence, force, threats or deception, causes or maintains, or endeavours to cause or maintain a concerted stoppage of work with the aim of forc-

[190] http://www.ilo.org/global/about-the-ilo/how-the-ilo-works/ilo-supervisory-system-mechanism/lang--en/index.htm informs over the ILO supervisory system.

[191] The reports can be accessed via the Committee's homepage: http://www.ilo.org/global/standards/applying-and-promoting-international-labour-standards/committee-of-experts-on-the-application-of-conventions-and-recommendations/lang--en/index.htm

[192] The information is taken out of the following documents: 2011-100-1A, 2012-101-1A, 2013-102-1A, 2014-103-1A, 2015-104-1A. They may be retrieved under: http://www.ilo.org/public/libdoc/ilo/P/09661/

ing an increase or decrease in wages or jeopardizing the free exercise of industry or work, shall be liable to a sentence of imprisonment of from one month to two years. The Committee then noted that a bill regulating the right to strike was in the process of being adopted.

Child labour

A recurrent theme in the examination of the situation in Morocco is child labour. In 2011, with regard to the Worst Forms of Child Labour Convention (C182), child domestic labour was the major theme. The Committee noted a statement from the International Trade Union Confederation (ITUC) saying that child domestic labour, performed under conditions of servitude, is common practice in the country, with parents selling their children, sometimes as young as 6 years of age, to work as domestic servants. The ITUC also indicated that some 50'000 children, mainly girls, are employed in domestic work. Based on a Moroccan study, they regularly get no schooling, are often beaten and exposed to the risk of (sexual) abuse. In 2011, the Committee welcomed that a Bill regulating the conditions of employment and work of domestic workers is in the process of being adopted. The CEACR report also refers to a National Multisectoral Programme implemented in collaboration with UNDP to fight child labour, and recalled the fact that ILO–IPEC launched an action programme to combat the use of young girls in domestic labour in the Marrakesh–Tensift–El Haouz region for the period from 1 January 2009 to 31 December 2010. In 2013, the Committee noted then with some consternation the Government's indications that, with the entry into office of the new Government, the Bill on domestic work had been withdrawn from Parliament and resubmitted to the Council of the Government on 12 March 2012, which deferred it for in-depth examination.

In its reports, the Committee expressed several times concern at the persistence of child prostitution and sex tourism involving young Moroccans and immigrants, particularly boys, despite an amendment to the Penal Code in 2003 making sex tourism a criminal offence. Most of these children begin to engage in prostitution after breaking off their school education (see below). The Committee regretted that the formulation of the national strategy to prevent and combat the sexual exploitation of children was still at the consultation stage.

The 2012 report focussed on the Minimum Age Convention (C138). It welcomed that the National Action Plan for Children (2006–15) had brought down the school drop-out rate in primary school from 5.4 per cent in 2006 to 3.1 per cent in 2010. With respect to child labour in the informal economy, the Committee noted the information provided by the International Trade Union Confederation (ITUC) according to which child labour was common in informal artisanal industries. It also noted that, according to a report entitled "Understanding Children's work in Morocco", some 372'000 children aged between 7 and 14 years, representing 7 per cent of the reference group, were engaged in work, while for the 12 to 14 age group, 18 per cent of children were economically active. According to this study, 87 per cent of working children were in rural areas where they were working in the agricultural sector. In urban areas, children were engaged in the textile, commercial and repairs sectors. The Committee noted the Government's indication that the outcome of the activities undertaken with ILO–IPEC support was as from 2010 as follows: 12'192 children had been removed from child labour and 21'694 had been prevented from working. At the same time, the report noted that children employed in informal artisanal industries, or formal artisanal industries involving five employees or less, do not benefit from the protection of the Labour Code and, consequently, from the application of the minimum age of 15 years. The Committee requested the Government to take measures to ensure that the minimum age of 15 years is duly applied to all children working in artisanal industries, to which the Moroccan government responded by pointing to the fact that the law making attendance of school compulsory protects children in this age class. The report then observed that labour inspectors were only authorized by law to enforce the application of the labour legislation when there is an employment relationship. Consequently, labour inspectors did not carry out any supervision in the informal economy and this might be changed, the Committee suggested.

The Committee welcomed that a new Decree replaced the Decree of 29 December 2004 and extended by over 30 the number of hazardous occupations prohibited for children (extending up to 18 years), such as greasing operations, the use of certain machines, demolition work, glass melting, any work exposing them to ionizing radiations, the manufacture or transport of explosives, and other types of work. It added that any person who violates the provisions prohibiting the employment of children under 18 years of age in hazardous types of work should be more systematically prosecuted and that sufficiently effective and dissuasive penalties are applied.

With regard to children employed as actors, the Committee 'once again' requested the Government to take the necessary measures to bring the national legislation into conformity with Article 8 of the Convention, so that permits granted to minors under 18 years of age allowing them to participate in artistic performances limit the number of hours during which and prescribe the conditions in which employment or work is allowed.

Discrimination

When examining the Equal Remuneration Convention (C100), the Committee pointed to the Code of Practice on equality in employment, prepared with ILO support, which was to be made available to enterprises wishing to establish a vocational equality strategy. With regard to vocational training, the assessment undertaken by the responsible Ministry showed a low participation rate of girls from rural areas (22 per cent of trainees), gaps between men and women in relation to training levels, a strong concentration of young girls in a small number of subjects in training, the low diversification of training supply for girls and the difficulties experienced by women who have received vocational training in entering the labour market. Better access to vocational training for women, as promoted by the Ministry, should help to further reduce the wage gap. The latter had been 5.5 per cent in the export sector and 40.3 per cent in “other sectors” in 1999, down from 9.6 and 28.9 per cent, respectively, in 1993, according to a paper from the Ministry. With regard to the Discrimination (Employment and Occupation) Convention (C111), the Committee noted that the activity rate of women between 2006 and 2008 decreased from 27.1 per cent to 26.6 per cent. It also noted the existence of significant horizontal and vertical occupational segregation (particularly in rural areas), the importance of women’s employment as family help in rural areas and of unpaid work by women (31 per cent of working women and 84 per cent of women in rural areas) and the high rate of unemployment among women graduates. The Committee noted that a Strategic Programme, which includes 14 projects, is focused around four main areas: (1) the mainstreaming of equality between men and women, thereby placing this principle at the heart of the preparation, implementation and evaluation of policies, programmes and political decisions; (2) the implementation of measures intended to integrate equality between men and women into the vocational training system (see above); (3) the improvement of knowledge of gender gaps and constraints with a view to the adoption of the appropriate corrective measures; and (4) the promotion of the access of women to positions of responsibility and decision-making bodies. It noted in particular the production of six guides on the use of the Labour Code for the Moroccan Association of Textile and Apparel Industries (AMITH) and the adaptation of ten training modules based on the provisions of the Labour Code, as well as the training of 60 trade union leaders on globalisation, and the reactivation of the Moroccan Joint Textile–Apparel Committee. In 2014, when looking again at the Discrimination (Employment and Occupation) Convention (C111), the Committee noted with interest the adoption of the Government Plan for Gender Equality “Ikram” (2012–16), accompanied by a significant budget, which provides for 143 measures and sets 24 goals in eight areas. These include: gender mainstreaming and the dissemination of gender equity and equality principles; measures to combat all forms of discrimination against women; women’s social and economic empowerment; and the achievement of equality of opportunity between sexes on the labour market. The Committee noted that, according to the Government, the National Agency for the Promotion of Small and Medium-Sized Enterprises (ANPME) had implemented a number of programmes to promote women’s access to entrepreneurship (only 10 per cent of enterprises are owned or run by a woman) and to address the various difficulties with which women are confronted when setting up their enterprise (limited access to credit, training and information). The Committee welcomed the fact that article 19 of the Constitution of 1 July 2011 provides for the establishment of the Authority for Parity and the Fight against All Forms of Discrimination (APALD). The Committee understands that the bill establishing APALD will soon be submitted to Parliament for adoption.

It is interesting to note that with regard to forced labour, the legal situation is primarily examined, whereas in the area of discrimination, the focus is on encouraging policies leading to more equity. With respect to child labour, both the legal situation and programmes in place are presented, with a focus on enforcement. This, of course, reflects also the situation in the field since with a predominance of women labour in smallholder farms and with a huge informal sector where, quasi by definition, labour contracts are absent, judicial enforcement of equal pay can hardly be envisaged. In the export industry, the situation appears to be far above the national average, but this translates also the fact that the latter is concentrated in the coastal region where the European influence on the way of life is much stronger than in the rest of this Islamic country.

The scrutiny with which the Committee proceeds appears also through the remarks addressed to Switzerland in these reports. The fact that national labour organisations (checked by employer’s organisations) can articulate their concerns, sometimes by intermediation through their international federation, helps to target very specific points.

The fact that public procurement legislation in developed countries requires often as a qualification criterion the respect of the ILO core labour standards makes those sectors interested in supplying public entities in foreign countries evidently more inclined to respect these provisions.

Supervising the Application of the Core International Labour Standards in Switzerland

Preliminary Remark: We do only consider here topics brought up in the reports 2011-2015 of the Committee of Experts on the Application of Conventions and Recommendations (CEACR) to the yearly International Labour Conferences as far as they refer to the eight conventions making up the core labour standards. We do neither consider here observations in these reports with respect to other conventions or the content of the direct requests the Committee addressed to the Swiss Government, nor any observations received by the Committee from either the employers or employees organisations. We also do not report on the two pending cases (which remain confidential) and prior cases (the last dates 2003) regarding the freedom of association conventions, complaints which are examined by a different committee.[193]

In 2011, the Committee took up the Right to Organise and Collective Bargaining Convention (C098). It questioned the opinion of the Swiss government that the compensation for unfair dismissal which may amount to as much as six months' pay is sufficiently dissuasive. This may only be sufficient in the great majority of Swiss firms which are small and medium-sized enterprises. It doubted also the way the law and case law address improper practices in collective bargaining (proven bad faith, unwarranted delay in the bargaining process, failure to comply with agreements, etc.). Regarding the first point, the Committee noted in 2013 that consultations on legal measures for a better protection of union members ended in January 2011 and regretted the fact that the Federal Council had not brought this issue before Parliament over a year and a half after the official consultation. In 2014, it requested then the Government to indicate the action taken by the Federal Council to follow up the public consultation.

In 2012, the Committee addressed the Worst Form of Labour Convention (C182). The Committee urged the Government to take the necessary measures to amend the Penal Code in such a way that the use of a child between 16 and 18 years of age for prostitution is prohibited as soon as possible. The same should apply with regard to the production of pornography. In 2014, the Committee then expressed the firm hope that the amendments to the Penal Code on the use, procuring or offering of a child under 18 years of age for prostitution, the production of pornography or pornographic performances (sections 196–197), as provided in the Order of 27 September 2013, will be implemented shortly.

The Committee looked in the case of Switzerland also at the discrimination (employment and occupation) convention (C111). The Committee was of the view that, although important, the anti-discrimination provision of the Constitution has on the whole been insufficient to remedy specific situations of discrimination in employment. The Committee accordingly asked the Government to re-examine the possibility of taking legislative measures to define and prohibit discrimination based on at least all the grounds enumerated in Article 1(1)(a) of the Convention, at all stages of employment, including in vocational training and recruitment and in terms and conditions of employment. The grounds enumerated there are discrimination based on sex, skin colour, ethnic origin, religion, philosophical conviction, age, disability or sexual identity. It pointed also to the "anti-racism legislation" and suggested the inclusion in the legislation of a ban on direct and indirect discrimination in work relationships between individuals and the establishment of effective instruments for enforcement. The Committee also asked the Government to continue to provide information on the awareness raising and information measures based on this law. In 2015, it asked the government to indicate the vocational guidance measures taken or envisaged to encourage young women to enter training in traditionally male fields.

[193] May be retrieved under http://www.ilo.org/dyn/normlex/en/f?p=1000:20030:0:FIND:NO:::

Chapter 12
Instruments sustaining Corporate Social Responsibility

1 CSR-Standards

In an article in the journal „La Vie économique",[194] edited by the Swiss Ministry of Economics, Johannes Schneider from the Swiss State Secretariat for Economic Affairs resumes the Corporate Social Responsibility standards which have internationally been adopted. Major elements are presented together with the main challenges facing companies when applying these standards; the role of politics is also discussed. We essentially reproduce here his text.

In 2010/2011, within a period shorter than one year, major reference documents for Corporate Social Responsibility (CSR) on the international level have been brought up to date. The release of the *ISO Standard 26000 on Social Responsibility*[195] in November 2010 was followed by the update of the *OECD Guidelines for Multinational Enterprises*[196] in Mai 2011 and by the publication of the *UN Guiding Principles on Business and Human Rights*[197] in June 2011. Finally, in October 2011, the EU presented its new CSR strategy.[198] The latter draws on the international development and integrates these evolutions in the action plan for the EU-States.

According to Schneider, the rapid evolution in the area of corporate social responsibility occurred not by chance but on the background of the tightening global competition with regard to access to natural resources and markets. Within the ongoing globalisation of companies and markets it proved necessary to involve also companies and investors of the emerging economies in responding to the ecological and social challenges of, also, a global dimension. Primarily, to master challenges such as global climate change or corruption is a responsibility of public authorities. Governments have to define appropriate framework conditions and to care for a thorough enforcement of the provisions companies are obliged to abide to. It is not up to enterprises to compensate for regulatory and institutional deficiencies. When active in countries with weak regulatory capacities, corporations will often go beyond the requirements of local legislation, however. They do so also in response to expectations from their clients. Customers attach increasing weight on goods being produced in a sustainable way.

Standards established by international organisations

The standards established by international organisations comprise primarily the *OECD Guidelines for Multinational Enterprises*, the *Tripartite Declaration on Principles concerning Multinational Enterprises and Social Policy* of the ILO and the *Global Compact* by the UN (cf. table below). Furthermore, as indicated, in June 2011, the UN Human Rights Council adopted the *UN Guiding Principles on Business and Human Rights*.[199]

Multi-Stakeholder-Initiatives

Within Multi-Stakeholder-Initiatives, actors out of government, business and the civil society jointly contribute with their knowledge to the implementation of Corporate Social Responsibility. Presently, there exist over a dozen such initiatives. One of the most recent examples is the comprehensive *ISO Standard 26000 on Social Responsibility* which was elaborated by such an initiative under the auspices of the *International Standards Organisation ISO* (see table). The encompassing *Guidelines for Sustainability Reporting*[200] were elaborated in an interaction of stakeholders as well, within the *Global Reporting Initiative*.

Frequently, Multi-Stakeholder Initiatives are sector-specific. They fix standards in response to the characteristic challenges emanating out of a certain production or transformation processes. An example is the *Extractive Industries Transparency Initiative (EITI)*. The latter supports the fight against corruption and in favour of good governance by requiring comprehensive disclosure on payments effectuated by mining companies in resource-rich countries.

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[194] See Schneider, Johannes (2012): Principes fondamentaux et instruments de la responsabilité sociale des entreprises, La vie économique, Berne: SECO. http://dievolkswirtschaft.ch/fr/2012/12/schneider-6/ .
[195] http://www.iso.org/iso/home/standards/iso26000.htm
[196] http://www.oecd.org/corporate/mne/
[197] http://www.ohchr.org/EN/Issues/Business/Pages/InternationalStandards.aspx
[198] http://ec.europa.eu/growth/industry/corporate-social-responsibility/index_en.htm
[199] These will now be transposed in strategies at the national level.
[200] http://www.iasplus.com/en/resources/sustainability/gri?set_language=en

Overview over selected international CSR-Instruments

	OECD-Guidelines for Multinational Enterprises	Standard ISO 26000 for Social Responsibility	UN Global Compact	ILO Tripartite Declaration on Principles for MNE and Social Policy
Adoption / last Modification	1976/2011	2010	2000/2004	1977/2006
Assignment	Recommendations of 46 governments to their internationally active companies	Guidelines on how to respond to corporate social responsibility for companies and organisations	Voluntary commitment made by participating companies; national networks provide platform for dialogue on CSR topics	Directives for multinational companies, governments and employers and employees associations
Chapters	Ten chapters regarding: General principles on e.g. diligence, disclosure of information, human rights, labour standards, environmental protection, combat of corruption, consumer interests, transfer of know-how and technology, competition rules, taxation	Seven topics: corporate governance, labour standards, human rights, environmental protection, combat of corruption, consumer interests, contribution to public welfare, education and culture in general	Ten principles referring to: labour standards, human rights, environmental protection, corruption	Labour standards regarding employment, training, working and living conditions, employer-employee relations at the workplace
Reporting and accountability	No reporting obligations; informal arbitration procedure under the auspices of national contact points	No reporting obligations; opposite to other ISO standards, ISO 26000 cannot as such be certified	Annual report on abidance and the promotion of the principles	No reporting obligations; the parties can ask the Secretariat of the ILO for an interpretation on how to apply contested provisions
Links	www.seco.admin/nkp www.oed.org	www.iso.org/sr	www.unglobalcompact.org	www.ilo.org

Other examples are the *Kimberley-Process*[201] to stem the flow of conflict diamonds or the *OECD Due Diligence Guidance for Responsible Supply-Chains of Minerals from Conflict-Affected and High-Risk Areas*.[202] Elaborated - and further accompanied - in a Multi-Stakeholder Process under the auspices of the OECD, the Guidance provides detailed recommendations to help companies identify risks and to proceed to a responsible supply-chain management. The objective is to avoid that companies contribute to conflict and to human rights violations by their decisions and practices when purchasing minerals. Other Multi Stakeholder-Processes serve sustainable fishery or forestry or the sustainable production of agricultural commodities such as coffee, cotton or palm oil.[203]

Industry-Codices

Industry Codices are elaborated in common by a group of companies or industry associations[204] and address by appropriate standards the social and environmental concerns the participating companies face. European companies created for instance the *Business Social Compliance Initiative (BSCI)* as a platform to improve socials standards in supply-chains. Suppliers of the close to 800 participating enterprises have to undergo an audit by which compliance with the social and ethical requirements of the BSCI-codex

[201] http://www.kimberleyprocess.com/

[202] http://www.oecd.org/corporate/mne/mining.htm

[203] FAO/OECD will presumably in 2016 release a Guidance for Responsible Agricultural Supply Chains (see http://www.oecd.org/daf/inv/investment-policy/rbc-agriculture-supply-chains.htm), and die OECD will publish a Due Diligence Guidance for Stakeholder Engagement in the Extractive Sector (see. https://mneguidelines.oecd.org/stakeholder-engagement-extractive-industries.htm). Additionally, the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector are in elaboration (see https://mneguidelines.oecd.org/responsible-supply-chains-textile-garment-sector.htm) and a Guidance on Responsible Business Conduct in the Financial Sector is in preparation (see https://mneguidelines.oecd.org/rbc-financial-sector.htm).

[204] In Switzerland e.g., economiesuisse released a publication „CSR aus Sicht der Unternehmen“ (see http://www.economiesuisse.ch/de/artikel/neue-publikation-corporate-social-responsibility)

is ascertained. Another example is the *Gold Standard* as released in October 2012 by the *World Gold Council*. This standard further details the *Supplement on Gold* of the *OECD Due Diligence Guidance for Responsible Supply-Chains of Minerals from Conflict-Affected and High-Risk Areas*. Numerous other industry codices are based on the reference documents available at the international level in order to transpose these general principles to the level of a specific industry for practical application.

Corporate codices

There are innumerable codices single companies have elaborated on their own behalf. UNCTAD estimates that in developing and developed countries, 90% of MNEs have adopted a CSR-standard. Approximately half of them make reference to the supranational reference framework as defined by the OECD, the UN and the ILO but the increasing number of relevant standards starts to become a problem. Efforts to harmonise the industry and corporate standards and to align the requirements emanating out of Corporate Social Responsibility for supply chains deserve all the necessary support. It must be avoided that companies when being part of supply-chains of global corporations have to respond to an excessively heterogeneous and possibly even conflicting set of charges emanating out of CSR-codices. Otherwise, small to medium sized companies, particularly out of developing countries, risk to see their access to global value added chains foreclosed.

2 Securing the Traceability of Gold

The international framework

The international framework is primarily made up by '*The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas' and its 'Supplement on Gold'* which we will briefly describe below:

The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: The financing of civil wars in several African countries by selling diamonds mined in conflict regions (the so-called blood diamonds) led, supported by UN Security Council resolutions, around 2000 to the Kimberly Process by which a group of producer countries set up a certification scheme to document the proper origin of commercialised diamonds. Subsequently, an extension of such activities to other minerals (tin, tantalum and tungsten plus gold) occurred through a collaborative government-backed multi-stakeholder initiative. Participating were OECD member countries and eleven countries of the International Conference on the Great Lakes Region (Angola, Burundi, Central African Republic, Republic of Congo, Democratic Republic of Congo, Kenya, Rwanda, Sudan, Tanzania, Uganda and Zambia). Involved were also industry, civil society, as well as the United Nations Group of Experts on the Democratic Republic of Congo. Later in the process, Brazil, Malaysia and South Africa were also represented in the elaboration of the OECD Due Diligence Guidance.[205] The result was adopted though a decision by which the OECD Council recommended that members and non-member adherents to the Declaration on International Investment and Multinational Enterprises actively promote the observance of the Guidance by companies operating in or from their territories and sourcing minerals from conflict-affected or high-risk areas. In particular, they should actively support the integration into corporate management systems of the 5-Step Framework for Risk-Based Due Diligence, made up of:

STEP 1: Establish strong company management systems

STEP 2: Identify and assess risks in the supply chain

STEP 3: Design and implement a strategy to respond to identified risks

STEP 4: Carry out independent third-party audit of smelter/refiner's due diligence practices

STEP 5: Report annually on supply chain due diligence.

The measures these five steps consist in are detailed in the text in a very pragmatic way. Enterprises may meet the requirements in a variety of ways, including but not limited to:

- Industry-wide cooperation in building capacity to conduct due diligence.
- Cost-sharing within industry for specific due diligence tasks.
- Participation in initiatives on responsible supply chain management.
- Coordination between industry members who share suppliers.

[205] See http://www.oecd.org/fr/daf/inv/mne/mining.htm

- Cooperation between upstream and downstream companies.
- Building partnerships with international and civil society organisations.

In principle, the scope of the guidance is geographically limited to conflict-affected and high-risk areas where the latter are identified by the presence of armed conflict, widespread violence or other risks of harm to people. However, a management system can difficultly insulate company activity within selected region. Also, an escalation can always occur and affect regions of a country with rather elaborate governance structures. Therefore, to be successful in practice, most of a company's activity will presumably need to be scrutinised.

Supplement on Gold: The 5-step procedure indicated above is made more precise through supplements. The latter consider that the process of bringing a raw mineral to the consumer market involves multiple actors. In the case of gold, the supply chain includes e.g. the extraction, transport, handling, trading, processing, smelting, refining and alloying, manufacturing and sale of the end product. The abilities of the actors in the supply chain deserve also attention. Artisanal and small-scale gold producers should not be deprived of their earning possibilities in favour of large and medium sized producers. Therefore, according to the supplement, artisanal and small-scale gold producers such as individuals, informal working groups or communities are not expected to carry out due diligence as recommended in this Guidance. However, they are encouraged to remain involved in due diligence efforts of their customers and to formalise their company so they can carry out due diligence in the future. Therefore, due diligence is understood as an on-going proactive and reactive process. Furthermore, it is stated that, as such, the Guidance is not a substitute for nor should it be considered to override domestic laws and regulations, including those relating to mining.

The Supplement is very practical and broken down to the operations within a firm. To refiners it is e.g. recommended to physically segregate and secure any shipment for which there is an unresolved inconsistency concerning its origin. Situations where a red flag should go up are also indicated. This is for instance the case when the gold is claimed to originate from a country through which gold from conflict-affected and high-risk areas is known or reasonably suspected to transit.

A critical aspect of all such initiatives is enforcement. It is therefore reassuring to know that the London Bullion Market Association (LBMA) has set up a Responsible Gold Guidance for Good Delivery Refiners[206] in order "to combat systematic or widespread abuses of human rights, to avoid contributing to conflict, to comply with high standards of anti-money laundering and combating terrorist financing practice". This Guidance formalises and consolidates existing high standards of due diligence amongst all LBMA Good Delivery Refiners and follows the five steps framework for risk-based due diligence of the OECD Due Diligence Guidance of 2010 as well as the requirements detailed in the OECD Gold Supplement adopted on 17 July 2012. All Refiners producing LBMA good delivery gold bars must comply with this guidance in order to remain on the LBMA Good Delivery List.

Despite such involvement of principal markets, claims were risen saying hat all the diligence efforts occur on paper but often not in reality.[207] The situation may change, however, also under the impact of the Dodd-Franc-Act in the USA.[208] Under this act, US enterprises are obliged to report to the Security and Exchange Commission over the origin of their natural resources and in particular whether they come from the problem zone constituted by the Democratic Republic of Congo and the country's neighbouring regions. This obligation produces effects along the whole value added chain. Medium sized suppliers of US firms, be they domestic or foreign, will have to declare to their US customers where the metals a.s.o. contained in their products stem from.[209] These suppliers will then in turn have to rely e.g. on the certificates of the International Conference of the Great Lakes Region ICGLR. The ICGLR has started, supported by the German Agency for International Cooperation GIZ, a certification procedure for mines requiring audits on the spot.[210] Providers can also rely on industry initiatives such as the one initiated for tin by ITRI. Within

[206] Indications taken from http://www.lbma.org.uk/responsible-gold

[207] http://www.swissinfo.ch/eng/commodities_ngo-reports-illegal-gold-imports-by-refiner/41706564

[208] http://www.marktundmittelstand.de/nachrichten/produktion-technologie/zertifizierung-in-der-lieferkette/

[209] For a similar effort in the European Parliament see "Conflict minerals: MEPs ask for mandatory certification of EU importers": http://www.europarl.europa.eu/news/en/news-room/content/20150513IPR55318/html/Conflict-minerals-MEPs-ask-for-mandatory-certification-of-EU-importers

[210] https://www.giz.de/de/weltweit/15662.html

this system, [211] indication numbers are given to single lots, so that the latter can be traced back to the producer.

The disadvantage with these approaches is, as said, that documents may be forged. This risk may be overcome when combined with the “analytical fingerprint” the German Federal Institute for Geosciences and Raw Materials (BGR) has developed. The BGR uses forensic methods in order to determine the place of origin of minerals. Based on a reference data bank, an identification of the provenance of ores down to the level of the single mine appears as possible. In order to fight terrorism, such fingerprints are in use to trace explosives for a certain time already. While, with explosives, the fingerprint is added in the production process, the approach of the BGR relies on the geochemical differences of the mineralization in the different mining zones.

The Better Gold Initiative – a Swiss multi-stakeholder initiative[212]

The Better Gold Initiative is a ‘responsible gold’-project formed through an alliance between the Swiss State Secretariat for Economic Affairs and the Swiss Better Gold Association, a group of major refiners and jewellers, alongside Max Havelaar Switzerland, a fair trade organisation.

The programme aims at bringing gold miners closer to the market in Switzerland, thus offering producers better prices through direct export without intermediaries while creating greater transparency and traceability of the gold supply chain for the end buyer. It also promises miners access to special funds as well as financing for sustainable development projects.

The authorities’ involvement in the initiative is to be seen on the background of the key role Switzerland holds in the international gold trade, with some 60% of all gold globally traded transiting through the country. The reason for this high share are the capacity and expertise in gold refining built up e.g. in the southern Swiss canton of Ticino. The four major Swiss refineries have the high quality product the jewellers want.

The complementary role of the BGI appears through the fact that the Responsible Jewellery Council (RJC), which most high-end jewellery businesses are signed up to, provides standards that are essentially applicable to large-scale miners. The World Gold Council also offers certificates for conflict-free gold that are essentially valid for large mining companies. However, it is estimated that, worldwide, 15-20% of gold comes from artisanal and small miners and these producers should also be given a chance. Unfortunately, up to date, only a small share of these producers is covered by the Better Gold Initiative, in spite of the issues that are at stake.

While concerns over the gold industry’s environmental footprint, and to a minor degree also concerns over health and labour issues, are anchored in the discussions about large scale project such as the Conga Mine in Northern Peru, small scale mining is all but innocent. Widespread deforestation, mercury pollution, alleged trafficking of persons and forced labour practices are amongst the concerns generated by illegal mining. Document trafficking is also a known fact, making e.g. the formalisation initiative of the Peruvian government an arduous task. Third-party certification groups such as Fairmined and Fairtrade by offering certification to small and artisanal miners, provided the latter respect certain social and environmental standards, are thus essential in promoting decent working conditions, human rights and the gradual elimination of mercury in small-scale mining. However, these laudable efforts require a significant input by the parties involved which will often not be made, and risk therefore to remain of limited impact.

3 Anti-corruption legislation

At the international level, two instruments complement efforts of national legislators to fight corruption. They provide them with a framework within which to enact:

The *Criminal Law Convention on Corruption* adopted by the *Council of Europe* in 1999 and the additional protocol of 2003.[213] Its implementation is monitored by the "Group of States against Corruption - GRECO", functioning since 1 May 1999. The Convention is wide-ranging in scope, and complements existing legal instruments. It covers the following forms of corrupt behaviour normally considered as specific types of corruption:

- active and passive bribery of domestic and foreign public officials;

[211] http://enact-kp.streamhouse.org/the-itri-tin-supply-chain-initiative-itsci/

[212] The text (except for the last two paragraphs) is taken from the document: “Bringing fair trade to artisanal gold mining”, prepared by Paula Dupraz-Dobias in Peru for Swissinfo.ch but was rearranged by the author (see http://www.swissinfo.ch/directdemocracy/better-gold-initiative_bringing-fair-trade-to-artisanal-gold-mining/37653264). The 2nd last paragraph is from the homepage of METALOR.

[213] http://conventions.coe.int/Treaty/EN/Treaties/Html/173.htm http://conventions.coe.int/Treaty/en/Treaties/Html/191.htm

- active and passive bribery of national and foreign parliamentarians and of members of international parliamentary assemblies;
- active and passive bribery in the private sector;
- active and passive bribery of international civil servants;
- active and passive bribery of domestic, foreign and international judges and officials of international courts;
- active and passive trading in influence;
- money-laundering of proceeds from corruption offences;
- accounting offences (invoices, accounting documents, etc.) connected with corruption offences.

The *United Nations Convention against Corruption* was adopted by the *General Assembly* by resolution 58/4 of 31 October 2003 and entered into force on 14 December 2005.[214] It has 140 signatories. In 2009, the terms of reference of the *Mechanism for the Review of Implementation of the United Nations Convention against Corruption* were adopted. The Convention highlights prevention, stating that corruption can be prosecuted after the fact, but first and foremost, that it requires prevention. An entire chapter of the Convention is therefore dedicated to prevention, with measures directed at both the public and private sectors. These include model preventive policies, such as the establishment of anticorruption bodies and enhanced transparency in the financing of election campaigns and political parties. States must endeavour to ensure that their public services are subject to safeguards. Prevention and criminalization complement each other. The Convention requires countries to establish criminal and other offences to cover a wide range of acts of corruption, if these are not already crimes under domestic law. In some cases, States are legally obliged to establish offences; in other cases, in order to take into account differences in domestic law, they are required to consider doing so. The Convention goes beyond previous instruments of this kind, criminalizing not only basic forms of corruption. A third element is international cooperation. Countries agreed to cooperate with one another in every aspect of the fight against corruption, including prevention, investigation, and the prosecution of offenders. Countries are bound by the Convention to render specific forms of mutual legal assistance in gathering and transferring evidence for use in court. Finally, the Convention provides for asset recovery, a major breakthrough and particularly important for many developing countries where high-level corruption has plundered the national wealth.

Swiss legislation on corruption evolved also under the impact of this evolution at the international level.[215] Between 2000 and 2006, Switzerland extended and tightened its criminal law on corruption in three stages. New is that the bribery of foreign public officials is now regarded as a criminal offence and that not only individuals, but also companies can be prosecuted for corruption. Several distinctions in Swiss criminal law on corruption may be noted. While bribing public officials and private persons who carry out a public function are prosecuted according to the *Swiss Criminal Code (StGB),* the bribery of private persons is regulated by the *Federal Law against Unfair Competition*. Unlike the bribery of public officials, the bribery of private persons is pursued under criminal law only on complaint. In bribery, the undue advantage is connected to a specific act or omission and the relationship is one of exchange. Advantages are not undue when allowed by staff regulations or when they are of minor value in conformity with social customs. In the case of bribing public officials either at home or abroad, individuals may be sentenced to prison terms of up to five years or fined. Bribery in the private sector results in imprisonment for up to three years or a fine. Criminal liability lies not only on management and staff, but also on those who otherwise act on behalf of the company. To oversee that management complies with laws, statutes, regulations, and orders is a non-transferable duty of the board of directors. A company ("legal entity") that "has not undertaken all requisite and reasonable organisational precautions" required to prevent the bribery of public officials or persons in the private sector is subject to criminal prosecution and a fine of up to five million Swiss francs. This liability applies regardless whether an individual can be called to account or not. A practical application occurred when Alstom was convicted to a fine of CHF 2.5mio in November 2011. Alstom had already adopted guidelines regarding the remuneration of 'consultants' and introduced internal schooling. To entrust enforcement in a MNE of 90'000 employees to three lawyers only had been considered insufficient by the Public Ministry, however, a ruling Alstom accepted.[216]

[214] https://www.unodc.org/unodc/en/treaties/CAC/

[215] http://www.seco.admin.ch/themen/00645/00657/00659/01395/index.html?lang=en

[216] See the Swiss compliance report addressed to GRECO in 2013. To be retrieved under: http://www.coe.int/t/dghl/monitoring/greco/evaluations/round3/ReportsRound3_en.asp

Chapter 13
Trade Related Aspects of Intellectual Property Rights

1 The international protection of intellectual property rights in general

The homepage of the World Intellectual Property Organisation WIPO provides a concise history of the development of intellectual property rights at the international level. We partially reproduce these indications here:[217]

1883 – Paris Convention: The Paris Convention for the Protection of Industrial Property is the first major step taken at the international level to help creators ensure that their intellectual works are protected in other countries. The need for international protection of intellectual property (IP) became evident when foreign exhibitors refused to attend the International Exhibition of Inventions in Vienna, Austria, in 1873 because they were afraid their ideas would be stolen and exploited commercially in other countries. The Paris Convention covers: Inventions (patents), Trademarks and Industrial designs.

1886 – Berne Convention: Following a campaign by French writer Victor Hugo and his 'Association Littéraire et Artistique Internationale', the Berne Convention for the Protection of Literary and Artistic Works is agreed. The aim is to give creators the right to control and receive payment for their creative works on an international level. Works protected include novels, short stories, poems, plays; songs, operas, musicals, sonatas; drawings, paintings, sculptures, architectural works.

1891 – Madrid Agreement: With the adoption of the Madrid Agreement, the first international IP filing service is launched: the Madrid System for the international registration of marks. In the decades that follow, a full spectrum of international IP services will emerge under the auspices of what will later become the WIPO.

1893 – BIRPI established: The two secretariats set up to administer the Paris and Berne Conventions combine to form WIPO's immediate predecessor, the United International Bureaux for the Protection of Intellectual Property – best known by its French acronym, BIRPI. The organization, with a staff of seven, is based in Berne, Switzerland.

1970 – BIRPI becomes WIPO: The Convention establishing the World Intellectual Property Organization (WIPO) comes into force and BIRPI is thus transformed to become WIPO. The newly established WIPO is a member state-led, intergovernmental organization, with its headquarters in Geneva, Switzerland. WIPO joins in 1974 the United Nations (UN) family of organizations, becoming a specialized agency of the UN. All member states of the UN are entitled, though not obliged, to become members of the specialized agencies.

1978 – PCT System launched: The PCT international patent system begins operation. The PCT expands rapidly to become WIPO's largest international IP filing system today.

1994 – AMC established: The WIPO Arbitration and Mediation Center is established. The Center offers alternative dispute resolution services to help solve international commercial disputes between private parties.

2007 – WIPO Development Agenda adopted: WIPO formally adopts its Development Agenda, with the aim of ensuring that development issues are taken into consideration throughout the Organisation's work.

2 The TRIPS Agreement

The Trade Related Intellectual Property or TRIPS Agreement[218], which came into effect on 1 January 1995, is to date the most comprehensive multilateral agreement on intellectual property. The TRIPS Agreement largely builds and partially extends the Stockholm Act of the Paris Convention of 14 July 1967 and the Paris Act of the Berne Convention for the Protection of Literary and Artistic Works of 24 July 1971. It also refers to the "Rome Convention", i.e. the International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations, adopted at Rome on 26 October 1961 and on the "Treaty on Intellectual Property in Respect of Integrated Circuits" (IPIC Treaty) adopted at Washington on 26 May 1989.

[217] See 'WIPO — A Brief History' under http://www.wipo.int/about-wipo/en/history.html

[218] http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm

Accordingly, the areas of intellectual property that the agreement covers - each in a separate section - are:

- copyright and related rights (i.e. performers, sound recordings and broadcasting);
- trademarks including service marks;
- geographical indications including appellations of origin;
- industrial designs;
- patents including the protection of new varieties of plants;
- the layout-designs of integrated circuits; and
- undisclosed information including trade secrets and test data.

The Agreement provides furthermore for certain basic principles, such as national and most-favoured-nation treatment, showing its inter-linkage with the GATT and GATS Agreements.

The Protection of Intellectual Property Rights in Europe[219]

To create a genuine Single Market in Europe, restrictions on the freedom of movement and anti-competitive practices must be eliminated or reduced as much as possible, while creating an environment favourable to innovation and investment. Against the background of these possibly conflicting objectives, the protection of intellectual property is an essential element for the success of the Single Market. The tensions appear e.g. though the EU decision to adopt the principle of regional exhaustion in the protection of intellectual property rights.

With respect to patents, the European Patent Convention (EPC) of 1973, a multilateral treaty instituting the European Patent Organisation, deserves mentioning. The EPC provides a legal framework for the granting of patents in the EPC member states via a single, harmonised procedure before the European Patent Office. A patent granted under the EPC is not a unitary right, but a group of essentially independent nationally-enforceable, nationally-revocable patents, subject to central revocation or narrowing as a group pursuant to two types of unified, post-grant procedures.

To replace this patent filing system by a unitary patent according to EU law had been discussed over decades, a breakthrough agreement having been reached in 2012. The European unitary patent will soon guarantee supranational protection for inventions in 25 countries across Europe. Meanwhile, the agreement to install a European patent court is currently being ratified by EU member states.

A patent granted through the EPO in Munich is part of a so-called ‘triadic patent’. Triadic patents are a series of corresponding patents filed at the European Patent Office (EPO), the United States Patent and Trademark Office (USPTO) and the Japan Patent Office (JPO), for the same invention, by the same applicant or inventor.

TRIPS is a compulsory requirement of World Trade Organization membership. It is an entry ticket to the advantages the WTO offers in general, and was as such pushed forward by Multinational Enterprises mainly from the US: States like Russia and China which were very unlikely to join the Berne Convention have found the prospect of WTO membership a powerful enticement so that they were ready to adopt the TRIPS standards, to create the compulsory domestic enforcement mechanisms and to accept dispute settlement by the WTO, i.e. the three main ingredients of TRIPS.

- Standards.

In respect of each of the main areas of intellectual property covered by the TRIPS Agreement, the Agreement sets out the minimum standards of protection to be provided by each Member, namely the subject-matter to be protected, the rights to be conferred and permissible exceptions to those rights, and the minimum duration of protection. The TRIPS Agreement adds a substantial number of additional obligations on matters where the pre-existing conventions (see above) are silent or were seen as being inadequate.

- Enforcement.

The second main set of provisions deals with domestic procedures and remedies for the enforcement of intellectual property rights. The Agreement lays down certain general principles applicable to all IPR enforcement procedures. In addition, it contains provisions on civil and administrative procedures and remedies, provisional measures, special requirements related to border measures and criminal procedures, which specify, in a certain amount of detail, the procedures and remedies that must be available so that right holders can effectively enforce their rights, and procedural difficulties in acquiring or maintaining

[219] More information through http://ec.europa.eu/internal_market/intellectual-property/index_en.htm

IPRs do not nullify the substantive benefits that should flow from the Agreement.

- Dispute settlement.

The Agreement makes disputes between WTO Members about the respect of the TRIPS obligations subject to the WTO's dispute settlement procedures.

Core provisions of the TRIPS Agreement
Copyright terms must extend at least 50 years, unless based on the life of the author. (Art. 12 and 14) (broadcasts 20 years)
Copyright must be granted automatically, and not based upon any "formality," such as registrations, as specified in the Berne Convention. (Art. 9)
Computer programs must be regarded as "literary works" under copyright law and receive the same terms of protection
National exceptions to copyright (such as "fair use" in the United States) are constrained by the Berne three-step test
Patents must be granted for "inventions" in all "fields of technology" provided they meet all other patentability requirements (although exceptions for certain public interests are allowed (Art. 27.2 and 27.3)); they must be enforceable for at least 20 years (Art 33)
Limitations or exceptions to exclusive rights shall be confined to cases which do not conflict with a normal exploitation of the work nor unreasonably prejudice the legitimate interests of the right holder
Importantly, members are left free to determine the appropriate method of implementing the provisions of the Agreement within their own legal system and practice (see below)

The obligations under TRIPS apply equally to all member states. However, the TRIPS Agreement allows Members to provide more extensive protection of intellectual property if they wish so. No special provisions for developing countries were allowed, but these countries were given extra time to implement the applicable changes to their national laws, in two tiers of transition according to their level of development. The transition period for developing countries expired in 2005. The transition period for least developed countries to implement TRIPS was extended to 2013, and until 1 January 2016 for pharmaceutical patents, with the possibility of further extension.

Since it extends the Paris and Berne Conventions, it is hard to argue that the TRIPS Agreement only regulates trade related matters. Moreover and surprisingly, in one essential trade related matter, the agreement remains indeterminate. Article 6 on 'exhaustion' stipulates that for the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4, nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights, making the WTO members' agreement to disagree on this issue explicit. Exhaustion refers to the chain made up of the development, production, initial and further commercialization of a product or service and specifies the stage in this chain after which the owner of the IPR has no longer any say on the further utilization of the goods and services protected by his IPR. Since IPRs remain to a considerable extent defined by national legislation (see below), it remained controversial in the negotiations whether an IPR owner should in particular have the right to block the importation of a good (or service) commercialised with his agreement in another country or whether the acquirer in the other country is free to commercialise his legal acquisition where in the world he prefers. In the first case, we have 'national exhaustion', in the second case 'international exhaustion', whereas the EU has introduced the principle of regional exhaustion (legally acquired goods and services protected by IPR can be sold and used in any EU member country when first acquired in an EU country). After a long political controversy, Switzerland also adopted in patent legislation the principle of regional exhaustion (with two exceptions).[220]

In 2001, developing countries, concerned that developed countries were insisting on an overly narrow reading of TRIPS, initiated a round of talks that resulted in the Doha Declaration. The Doha declaration is a WTO statement that clarifies the scope of TRIPS, stating for example that TRIPS can and should be interpreted in light of the goal "to promote access to medicines for all." In the language of the IPR community, it was accepted that the "flexibilities" (or better, indeterminateness) of the TRIPS Agreement with regard to the admissibility of compulsory licensing, parallel importation, data protection, research and other exceptions to patentability, etc. may be used by countries to this end.[221] By a decision of

[220] See https://www.ige.ch/en/legal-info/legal-areas/patents/parallel-imports.html

[221] See in particular Paragraphs 4 and 5 of the Doha Declaration of 14 November 2001.

6 December 2005, the TRIPs agreements was amended. To address the public health problems afflicting many developing and least-developed countries, especially those resulting from HIV/AIDS, tuberculosis, malaria and other epidemics, other member states were given the right to fabricate on their behalf suitable pharmaceutical products (including active ingredients necessary for its manufacture and diagnostic kits needed for its use). As eligible importing members were declared: any least-developed country Member, and any other Member that has made a notification to the Council for TRIPS of its intention on how to use the system as an importer (in whole or in a limited way, for example only in the case of a national emergency or other circumstances of extreme urgency or in cases of public non-commercial use).The finding in a 2005 report by the WHO[222] that many developing countries had not incorporated TRIPS flexibilities into their legislation to the extent authorized under Doha was conducive to the adoption within the WIPO of a Development Agenda in 2007. The Agenda comprises 45 recommendations and the Committee on Development and Intellectual Property (CDIP), established by the WIPO General Assembly in 2008, is mandated to develop a work-program for implementing the 45 adopted Development Agenda recommendations.[223]

Another controversy emerged over the TRIPS' Article 27 requirements for patentability "in all fields of technology", and whether or not this necessitates the granting of software and business method patents. While the US know patents in these areas, in a ruling in 2000, the German Patent Court denied that software (and even more so business methods) conform to the requirement of being a technical innovation. This requirement exists in order to delimit the scope of patents from e.g. the scope of copyrights (the latter being available for computer software). A proposal by the Committee on Legal Affairs of the European Parliament to clear the point in a directive aborted in 2005. Since then, clearance is sought by way of case law. The situation being all but clear, the President of the European Patent Office referred a number of questions to the Enlarged Board of Appeal of the EPO in order to gain guidance on the finer aspects of the patentability of computer programs. In opinion G 3/08 the Enlarged Board found that any possible divergence in jurisprudence over time was a normal development in a changing world, and that the practice of the EPO, while not the only one imaginable, was practicable and reliable in its results.[224] The more a technical problem (such as the transmission of data) is at the core of the patent sought for, the more the second criterion - namely whether the solution submitted constitutes an innovative act - becomes also important. To fulfil this criterion, the solution must not be obvious to a technically skilled person active in the respective field of science.

3 The Glivec case of Novartis in India

In 2013 the highest court of India had to decide on a patent litigation case involving the Glivec drug produced by Novartis.[225] Glivec acts against cancer but the active substance can also have beneficial effects with respect to other diseases. Novartis wanted to protect the beta crystalline form of an active ingredient named by the WHO by the non-proprietary name 'Imatinib'. It is important to note that Novartis did not want to protect the method to produce this beta crystalline form out of the basic substance. Novartis claimed that the beta crystalline form was a substantial improvement over the original substance which had been patented in 1995 in the US and Europa, and constituted therefore a new medicine. Opponents of Novartis intervening in the case in India argued that the patent claim of Novartis was an attempt to 'evergreening' a patent that had already been granted. 'Evergreening' refers to the attempt to obtain a new period of patent protection after only minor changes had been brought to the initial medicine. In deciding the case, the flexibilities the TRIPS agreement concedes to the national lawmaker were of considerable importance.

India had significantly tightened patent legislation in order to conform to the obligations that fall on WTO member-states. Also to protect the domestic industry which had become a major provider of the world with generic, the Indian legislator had the ambition to foreclose patent protection to new drugs which were not a true innovation over existing medicines. The debate in Parliament led to

https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_trips_e.htm

222 Musungu, Sisule F. and Cecilia Oh (August 2005): The use of flexibilities in TRIPS by developing countries: can they promote access to medicines? Commission on Intellectual Property Rights, Innovation and Public Health, WHO

223 For more information see: World Intellectual Property Organisation (2007): Development Agenda, http://www.wipo.int/ip-development/en/agenda/

224 Quote from https://www.epo.org/news-issues/issues/software.html as of October 2015

225 supremecourtofindia.nic.in/outtoday/patent.pdf

the adoption of section 3(d) saying that "the mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance" does not constitute an invention under the act.

Novartis advanced different arguments why a patent should be possible under the reformed Indian legislation, which the Court reject after due examination, but the final point to be examined was whether the bioavailability of the beta form (which according to Novartis was 30% higher than the one of the formerly commercialised substance) constituted a sufficient increase in efficacy. The court found that 'efficacy' means "the ability to produce a desired or intended result" and that in this regard not all advantageous or beneficial properties are relevant, but only such properties that directly relate to efficacy, which in case of medicine is the therapeutic effect. The Court went on to quote pharmaceutical literature stating that it is not the intent of a bio-availability study to demonstrate effectiveness, but to determine the rate and extent of absorption. Therefore, the patent Novartis had sought was denied.

Difficulties in designing a suitable patent system

In the present context, it is interesting to note that the word 'patent' is derived from the Latin verb 'patere', which means 'to be overt'. Indeed when a patent is granted, the patent holder is obliged to make a comprehensive description of the innovation accessible to the general public. This will not only facilitate reverse engineering but also future research, since the common knowledge base of today is the starting point for research that will lead to the knowledge base of tomorrow. By creating a patent system, society offers companies a deal: In exchange of protection during the life span of the patent, knowledge suitable for future research is not concealed but immediately disclosed. Legislation cannot set the optimal duration of a patent on a case by case basis so that the GDP-increase reaches a maximum. The legislator has to make a guess what suits growth prospects best and has commonly chosen 20 years as the lifetime of a patent, assorted by some fees and private enforcement, with the effect that patents are not necessarily enforced over their full life span. How long a patent runs is not the only problem with the design of an ideal patent system, however. If the patent holder can uphold a series of related patents only using perhaps one of them, he forecloses competitors the way to innovate by circumventing his patent. This will delay the introduction of superior technology and may prove to be a disadvantage from the point of view of the nation-wide GDP. How broad a patent claim may be and if every patent has also to be exercised in productive activities is therefore also a point delicate to regulate. In a similar direction act the legal requirements regarding novelty of the patent. Research, experimental development, development of a new product series or to customize an existing product for a new group of clients go along with different direct costs and risks regarding the return on investment. Benefits for society of successful innovation may fall along the same categories. But how to delineate these categories by law and how to decide whether only research or also one of the other categories of development activity merit patent protection. Additionally, it may be wrong to grant patent protection to fundamental innovations if the latter boost knowledge so much that GDP and welfare jump upwards with the effect that the early write-down of the investments of the incumbents may be largely paid for. Expressed differently, from the point of view of social welfare, it may be appropriate to expose patent holders to the risk that achievements of government sponsored fundamental research lead to an early depreciation of private investments. There are also problems of abuse of the system in the sense that companies holding patents obstruct the second part of the deal with community by erecting patents on research tools to delay replacement of their latest innovation. Finally, specific issues of competition policy have come to the fore in recent years under the heading of "patent thickets". In fields where a lot of research is going on, numerous patents may be of relevance, but the ambiguity of patent claims may make it difficult to assess their relevance. Some large companies have therefore decided to create patent pools, the contracting parties granting each other mutual access to their patents at predetermined conditions in order to avoid costly patent litigations with indeterminate outcome, This precludes market entry, however. There is also the inability of judges to understand frontier research e.g. in microbiology, combined with the presence of a sufficient number of researchers that will provide an expertise with a bias towards a company, the latter showing its gratitude by sponsoring the researchers (on spot or eventually only later). It is on this background that the following saying becomes intelligible: If a community has a patent system, there are sufficient reasons not to dispose of it, if a community has no patent system, there are sufficient reasons not to introduce one." Since to sign the TRIP agreement is part of the deal to become a WTO-member, the second part of the assertion has lost its relevance. The debate is over the optimal design, not the introduction of a patent system.

The decision of India's highest court met criticism by experts in intellectual property rights. Some of them would have preferred if India had followed the approach chosen in IPR rights in the USA (and possibly other important jurisdictions). There the emphasis is put (solely) on the criterion whether to offer a new variety of a known active substance is an obvious way of transforming and repackaging the original variety for which a patent was claimed or whether the new variety builds on a true innovation bringing forth an improvement in treating patients. Furthermore, the improvement is assessed in terms of a better efficiency, the latter notion generally being understood as a better ratio of input to output. Legal experts using this argument do not consider that the Indian lawmaker foreclose this way of arguing since according to the amended law a new patent may only be granted based on an improved efficacy, efficacy meaning the effect produced in the target. If the administration of the enhanced initial drug is less onerous, but the drug produces still the same effect (e.g. in prolonging life expectancy), a new patent for the modified substance can accordingly not be granted in India.

The notion of efficacy appears to be rather well defined in the pharmaceutical science. Beyond the effect on the illness to be treated, eventually the toxicity of the treatment enters additionally into consideration, but apparently not much more. Novartis tried to argue that the new variety had enhanced bio-availability. If less of the drug is needed but the improvement in the health condition of the patients remains the same, we have increased efficiency not increased efficacy, however. The fact that a patent for a substance and not for a process is sought for lends some support to India's approach of emphasising efficacy in granting patents for active ingredients. The process of bringing the active substance in a new form may namely still obtain a patent if not obvious to an expert in the field. To stipulate for the latter class of inventions limitations of exclusivity rights appears as admissible based on what is admissible with regard to the protection of utility models.[226] The limitation would consist in the fact that it would be possible to arrive with other procedures to the modified active ingredient, possible some which qualify as obvious to an expert in the field. While no panel decisions are at disposal, it therefore does not appear to the author that TRIPS forecloses the possibility of the lawmaker to make the granting of a new patent for substances depend on the criterion of efficacy and not on the generally broader notion of an enhanced efficiency. Traditionally, the requirements the innovative act has to fulfil differ between jurisdictions.

Problematic aspects in the court's ruling are the extensive presentation of the history of patent protection in India which comes close to require that patent legislation should favour the development of a domestic industry. It is also an open question when and to what extent the affordability by all parts of the population can guide a court. While these controversial points are present in the 112 pages ruling of the court, it cannot be said that these reflections - presented in the first half of the decision - had a direct bearing on the final decision. In the author's view, the country conformed to the obligation in TRIPS Article 41:4 on judicial review.[227]

The case hardly merits to be considered a leading case. It falls in the category where patent holders argue that a new product falls within the coverage of an existing patent whenever a competitor wants to penetrate a market and where they argue that a rather incremental innovation entitles the company to a new patent when the development occurred within the company. How large to define the scope of a patent is a well-known difficulty inherent to patent legislation. The proof that we are confronted with such a benchmark case is given by the difficulties registration knew in the USA where the corresponding patent was only granted in an appeals procedure where it was accepted that the "manipulative step" of switching to the beta crystalline form of the active ingredient constitutes a sufficient innovatory act. In the end, the Indian legislator by requiring an improvement in efficacy and not only in efficiency had successfully used the flexibilities of the TRIPS agreement to limit the patentability of in-

[226] See in CDIP/5/4 of 1 March 2010 section 4 (3).

[227] "Parties to a proceeding shall have an opportunity for review by a judicial authority of final administrative decisions and, subject to jurisdictional provisions in a Member's law concerning the importance of a case, of at least the legal aspects of initial judicial decisions on the merits of a case."

cremental innovations. The case is helpful in illustrating the tasks of the legislator and the courts, namely to create sufficient incentives for significant innovations while securing an affordable provision of basic medicines to the whole of the population. This dilemma impacts also on the free trade agreements Switzerland currently negotiates as the next section will show.

4 TRIPS flexibilities versus TRIPS plus[228]

Switzerland has the ambition to lay down in free trade agreements provisions in the interest of pharmaceutical research that go beyond of what the basic obligations of WTO members according to the TRIPS agreement are. Mainly two aspects (which are besides part of national legislation within Switzerland) are disputed. The first one is the facility to extend the period for which a patent normally holds in the area of pharmaceuticals by five years. The argument for such an extension is that the patent claim has to be filed at a moment where the drug that will result out of the successful research effort is far from being able to be commercialised. The extension facility shall preserve for pharmaceutical research and resulting products an anticipated payback period thanks to exclusive marketing rights equivalent to those prevailing in other scientific areas where patents are of relevance but where product admission requirements do not curtail the period during which a patent is generating revenues. The second contested aspect is the access to the data the holder of rights to commercialise a drug submits to admission authorities. To replicate all the tests needed to get admission when the admission of a genericum is at stake is not indicated for ethical reasons in at least two circumstances: It may make it necessary to expose patients to inefficient treatment and it may involve unnecessary suffering for animals when exposed to experiments. For the economy as a whole, it is barely efficient to invest money to reproduce information already available. Thus, ideally, a compensation for data utilisation should be negotiated. The immense costs pharmaceutical companies incur between the successful conclusion of a research project and the point where a new drug is admitted and can be commercialised should be taken into account. To grant an adequate payback period also on these investments is in the interest of the well-functioning of the patent system. In making the development of new drugs relatively more attractive, pharmaceutical companies may become less inclined to engage their scientists in efforts to evergreen existing patents. This is tantamount to saying that the arguments in favour of TRIPS plus provisions become fragile once the owners of the data did not have to incur substantial costs for R&D and clinical testing. The argument becomes also delicate in countries where a broad segment of the population only gains access to essential medicines once generica come on the market. TRIPS plus provisions in FTA with developing countries are therefore primarily exposed to critique. If a competitive market for research in new drugs and treatments is assumed, the underlying question is which countries have to contribute financially to what extent to preserve incentives for ongoing pharmaceutical research. This remains a question which cannot be answered on scientific grounds only but needs to be decided by politics.

[228] For a review of TRIPS plus provisions see e.g. El Said, Mohammed K. (2010): Public health related TRIPS-plus provisions in bilateral trade agreements: A Policy Guide for negotiators and implementers in the WHO Eastern Mediterranean Region, published by the International Centre for Trade and Sustainable Development and the Regional Office for the Eastern Mediterranean of the WHO, Geneva, 1 December 2010.

Chapter 14
Is there a Need for a Global Agreement on Competition?

1 The freedom of contract – how the concept evolved in Switzerland
2 Competition policy by way of opening up the economy: The aspect of firm heterogeneity
3 Competition policy by way of competition legislation: The case of an oligopolistic retail sector
4 Is there a need for an international agreement on competition policy?

It is not evident why to address retailing in a text on globalisation. Retail markets are typically delineated along national borders, the market share cross-border shopping holds in the case of Switzerland being rather exceptional. The interest of looking at the retail sector stems from the fact that this sector connects producers with possibly a global focus to local customers. Depending on how the retail sector functions, the extent by which changes in competitive positions of producers reach final customers will differ, particularly in the short term. The typically oligopolistic market structures in retailing make e.g. the transmission of exchange rate changes into consumer prices highly uncertain, thereby also modifying the reaction of the whole economy to exchange rate shocks, as part II of Chapter 15 in the underlying publication demonstrates. Competition on domestic markets in general and the application of national competition legislation in the retail sector in particular are therefore of considerable importance also in an international context.

The intensity of competition much depends on how the freedom of contract is used and protected. A first point to be examined below is whether retailers can exercise the freedom of contract independently of whether the provider is domestic or foreign. A second point is to examine the steps taken by competition authorities against eventual anti-competitive behaviour. In this regard, an important distinction needs to be made between fighting cartels on the one hand and, on the other, the abuse of a dominant position and the constitution of dominant market positions by M&A. It is the latter two cases that may pose problems of international coordination, in particular when M&A are allowed but linked with charges such as to sell off certain activities. This can impact on employment in foreign countries and make considerations of industrial policy enter the decision of competition authorities. The third point to be examined below is whether there is a need for a global agreement of competition. The principal response given to this question will be the following: The applicability of the principle that competition legislation of the country where sales take place applies reduces the need for such negotiations in an essential way.

1 The freedom of contract – how the concept evolved in Switzerland[229]

Economic freedom is usually not ranking among the fundamental human rights, and if it is, it is usually seen as being constituted or as being a corollary of the right to private property. An often occurring reduction of this freedom to the right to choose one's contracting parties and to trade with them on any terms and conditions one sees fit also suggests that this freedom is of particular importance for merchants. This is not a very helpful connotation, however. Somewhat surprising, the freedom to choose and to exercise a profession is not given comparable attention in the public reception of writings of liberal authors;[230] this freedom of choice may also not figure prominently enough in their writings. Economic history and the former designation of economic freedom in the Swiss Constitution as the freedom of trade and the professions would suggest a different emphasis. Not to be able to freely choose the profession one wants to exercise or to be obliged to exercise a profession within strictly imposed constraints such as those imposed in medieval times by the guilds easily qualifies as a serious infringement of individual freedom. Freedom regarding the way one organises one’s business deserves also protection. Considering this link to personal freedom, economic freedom is more than just instrumental in achieving a high GDP, a view welfare economics tend to adopt.

A look at the evolution of the economic order in the 19th century in Switzerland supports the point that the notion “freedom of contract” misrepresents the scope of this liberty. Similarly to the

[229] The contribution “politique industrielle” in the Dictionnaire hstorique de la Suisse presents a brief summary of the following presentation; see: http://www.hls-dhs-dss.ch/textes/d/D13727.php).

[230] See e.g. Friedrich A. Hayek “The road to serfdom” or Milton Friedman “Capitalism and Freedom”.

United States, the freedom of contract in the Constitution of 1848 was mainly conceived as a freedom for interstate trade. Particularly the canton of Basel-Stadt upheld restrictions in the access to the crafts beyond the adoption of the first federal constitution of 1848. It was the constitution of 1874 that added to the freedom of (interstate) trade the freedom of the professions. The authorities of the time considered that the latter right was better protected in Switzerland than in the other countries.

With this broad understanding in mind, it becomes intelligible why the Federal Court in Switzerland barred the canton of St.Gallen of introducing a tax affecting retail trade when organised in a specific form. The ruling confirmed that any interventions into the market economy with the intention to shape the structures of the economy in a particular sense is the sole competence of the federal legislator and that the latter needs a specific, i.e. case by case entitlement in the Constitution to adopt legislation with such an intended effect. In detail, the verdict of 27 September 1919 in the case opposing ‚Magazine zum « Globus » A.-G.‘ and co-claimants and the Canton of St.Gallen (BGer 45 I 347) observes with respect to the article in the constitution laying down the freedom of contract and the professions what follows (translation by the author):

„The Article confers an individual right of freedom to the citizen. He is entitled to deploy his individual skills and his material possessions in an unimpaired manner for economic purposes unless such utilisation defies the higher ranking interests of the community. … Taxes creating inequalities among competing merchants and tradesmen are by principle prohibited if they affect the system of free competition without valid legal reason."

The Court suspended the law since no reason to tax specifically department stores and secondary outlets could be made out. The ruling acknowledges, however, the possibility to limit the economic freedom in the interest of the common good. Following the distribution of the competences according to the Swiss Constitution, only the Confederation is entitled to enact such legislation, however. So the Canton of St.Gallen lost the case.

At the national level, for decades, a controversy then held on whether the Confederation is entitled to enact laws only in the case such legislation is explicitly foreseen in the Constitution or if this supplementary requirement does not hold. Since the end of the 19th century, representatives of small scale businesses lobbied for submitting competition to a regime (and this is synonym to limitations) with the idea to restrict thereby more powerful competitors in the deployment of their economic capacities. It was understood that such legislation would go beyond the protection of public order and safety, the cantons already holding an entitlement for such legislation. To shape the outcome of free competition was the goal and to this end it was postulated that regulations adopted by industry associations on the way their commerce should be exercised can be declared compulsory by the Confederation. Obviously, this proposal needs to be seen as an expression of corporatism, the political strand gaining importance in these years throughout the Continent.

With the associated decline of liberalism at the turn to the 20th century, the Federal Council got obliged by Parliament to submit an amendment of the Constitution by way of an Article 34ter allowing for an extension of privately agreed rules on organising a certain business to all competitors. The dispatch to Parliament he had to prepare shows, however, the reservations he felt with regard to the adoption of an economic regime making it possible to interfere in the interplay among competitors sector after sector in the said way. The Council of State (Senate) then rejected the amendment of the Constitution by an Article 34ter, and the National Council (House of Representatives) did no longer insist on such an amendment, but the debate left the question unanswered how this signal by the legislator should finally be interpreted.

In the years that followed, legislation infringing the freedom of contract as laid down in Article 31 of the Constitution without explicit constitutional entitlement was adopted. Specifically, in the 20' an interdiction to construct new hotels was stipulated, and in the 30', legislation turned against department stores and new forms of retailing such as the ones practised by the retailer Migros, namely sales wagons, was enacted. Finally, an interference in the market for shoes occurred. In the following two subsections we will have a closer look at the latter two interventions.

The attitude to new forms of retailing

The reason for the adoption of a legislation protecting existing retail businesses was the slump of demand due to the Great Depression. The intervention reflects the exercise of pure political power, because it is by no means evident that retailers suffered from the difficult economic conditions of the time particularly. The fact that other circles went also through economic difficult times and had to make special efforts for economic survival is expressed in the dispatch the Federal Council had to submit. With respect to the ban for new department stores, he observes (translation by the author): "We must not over-estimate the effects of government measures for the recovery of the retail sector. The consultations with representatives of commerce showed that redress has primarily to come from within the trades. We strongly suggest to follow this path of self-help, in advance of further legislative measures. Our proposal is not a fundamental rejection of the department store in his traditional form. With a large number of insightful representatives of the retail sector, we share the view that a department store when run in a sound manner has its raison d'être and performs useful functions in modern economic life. As a highly streamlined form of retailing, it is suitable for the distribution of goods to a population with simple claims. The business model to increase sales by low consumer prices may also, if it is realized in moderation, exercise beneficial effect on the overall price level. We are convinced that a large part of the Swiss population would not understand a principally hostile attitude to these businesses and not adopt corresponding legislation."

The ambition to fundamentally review the part in the Swiss Constitution dealing with the economic regime provided a formal justification to enact the ban on new department stores for the time being only on a temporary basis. In the dispatch of 1935 proposing the adoption of new articles on the economic order[231] we then find a rejection of the view that the economic freedom may be constrained by creating a sufficient legal basis only at the level of a formal law. We quote: "By contrast, it is not admissible to fight the effects of free competition as such, even if they are harmful; economic restrictions of any kind are to be rejected in the future if rooted in economic policy considerations. It is not admissible to limit the number of traders or the amount of sales, nor to impose a price for the goods or a requirement regarding the quantity or quality produced. To suppress certain commercial forms because of their far-reaching economic consequences or to prefer individual traders over others shall also be inadmissible." The article in the Constitution relevant in the post WWII period limited therefore the possibility to deviate from economic freedom to the preservation of sectors and professions which see their existence at risk or to the protection of economically endangered parts of the country; the industries and professions seeking protection would also have to take those measures of self-help one could reasonably expect of them.

In the 60' and 70', as already in the 30', some constitutional experts chafed at the protection of the freedom of commerce by the Art. 31 and 31bis of the Constitution and postulated an 'economic constitution of economic policy'. They took advantage of the point that other liberties could be restricted solely by enactment of a law, without explicit authorization by the Constitution, so the protection of economic freedom seemed disproportionate to them. The new Federal Constitution of 1999 brought then a welcome clarification of this controversy by separating the individual right's dimension and the system-constitutive dimension of this principle. Economic freedom as an individual right was granted by way of a new Art.27 amidst the catalogue of the other fundamental rights. It reads:

> *Art. 27 Economic freedom*
>
> *1 Economic freedom is guaranteed.*
>
> *2 Economic freedom includes in particular the freedom to choose an occupation as well as the freedom to pursue a private economic activity.*

We do no longer find the requirement of a constitutional basis for limiting legislation in this Article. Thus, this freedom is no longer singled out and placed above others. However, as a general principle, legal restrictions may not cut into the core content of a fundamental right. Paragraph 2 expresses, in a non-exhaustive manner, what makes up the core content of economic freedom. There is a clear guarantee for the free choice of one's profession (see the considerations in the first paragraphs of this section). Secondly the monopolization by the State of more than single economic activities or the imposition of a general licensing requirement for doing business is prohibited.

Simultaneously, economic interventions remain limited by barriers at the level of the Constitution. Article 94, anchoring the systemic decision in favour of a market economy, contains a paragraph 4 which reads: "Deviations from the principle of economic freedom, in particular measures which are directed against competition, are permitted only based on a provision in the Federal Constitution or by pre-existing cantonal monopoly rights." The consequence is that in the interest of preserving a market economy, the Federal Parliament has no final say. Decrees which restrict the economic freedom have to take the barrier of a higher quorum, namely an approval of a supporting constitutional amendment, and this requires a majority vote by the people and the cantons. This, too, is entirely consistent with the basic principles of the Swiss Constitution. The

[231] Due to WWII and the plenipotentiary War-Regime (e.g.the rationing of basic nutritional goods) the introduction of a renewed economic constitution was only submitted to a popular vote in summer 1947.

latter allows the federal legislator only the adoption of laws if competence adequate for the purpose of the law has prior been attributed to him by the Constitution. And this transfer takes place in the economic sphere in such a way that the principle of competition may not generally but only on a case by case basis be limited by the enactment of laws.

The attitude to boycotts

The second infringement of economic liberty occurring in the 30' had a clear international dimension since it was targeted against the Czech shoe manufacturer Bata.

Bata rationalised shoe production before WWI by changing from an artisanal manufacturing of leather shoes to the production of galoshes on assembly lines, selling them also in own shops. Bata therefore was capable to undercut the prices of other shoe manufacturers and their retailers considerably, and this was particularly felt by competitors when the world economy fell in the Great Depression. The fact that Bata created one of its model factories in Möhlin in Switzerland did not help, he ran into the fervent opposition of the established shoe manufacturers, the shoe retailers and the intermediate trade. In fact, the three groups – all three organised as a cartel – allied and decided a boycott on Bata. Retailers which put Bata shoes on their shelves were cut from being supplied by the members of the cartel, there name being made public. Special relations to the Ministry of Economics – the nephew of the Federal Councillor was the secretary of one of the associations – helped the cartelists organise government support. A prohibition to open new outlets was decided with retro-active effect so that Bata had to close a shop the company had already opened in Lucerne, and an extension of the factory in Möhlin already under construction was blocked by a cantonal decree in spite of the fact that more than 90% of the population of this village complained to the cantonal government for limiting the offer of badly needed working places in the region. In a second stage, even certain prices were declared compulsory by a decree. Meanwhile, competitors started to copy the way Bata produced shoes and were given exceptional allowances to expand their production sites.

Situations like the one described where economic freedom is no longer guaranteed have a deterring effect on foreign trade. Why enter a foreign market when this investment will after a short time prove useless because market opportunities are soon denied by new legislation whenever a foreign competitor is too successful? To know how far and how easily the legislator interferes in markets is also relevant for an appreciation of how quickly decisions of competition authorities risk to be overruled and made ineffective by later legislation, given that competition authorities usually cannot challenge market regimes the legislator had put in place by specific legislation. An international comparative measurement of such deterrent experiences stands out.

The epilogue

In 1945, the ban on building hotels, the department store ban and the restrictions in the shoe industry were not renewed. However, it would be wrong to think that since then new forms of distribution in Switzerland can develop unimpaired. By the exercise of the competence of the legislator to enact social legislation and to adopt spatial planning regulations a protection of competitors may still be operated in a disguised manner. [232]

2 Competition policy by way of opening up the economy: The aspect of firm heterogeneity

The preferred way to create competition on domestic markets is in our view to open up the economy. To create competition by way of competition legislation has the disadvantage that enactment occurs by way of discretionary action. Competition authorities judge the opportunity of launching an investigation. In an open economy, the threat of market entry is always present. Furthermore, the opening up of markets shifts business to more productive foreign firms and calls for reaction by the incumbents.

In the process of opening up, some local producers will lose out. Judged from the aspect of political correctness, it would be suicidal to advocate opening up to trade because it starts such a Darwinian selection process. But in defence of the usefulness of this selection process, a quote by the Swiss writer Friedrich Dürrenmatt may help: "Within [the evolution] death makes sense. Otherwise we would be monads [unicellular organisms], involved for millions of years in a senseless process of self-division, covering the world with a mash."[233] The opposite to a shapeless conglomerate of companies operating at a very

[232] Decisions by the Federal Court detailing the freedom of contract in retailing are not missing. With respect to interfering social protection legislation, the decision BGE 97 I 499 (Griessen) may be mentioned, with regard to territorial planning the decision BGE 109 Ia 264 (Celerina).

[233] Friedrich Dürrenmatt (1989): In ihr [der Evolution] hat der Tod einen Sinn. Ohne ihn wären wir

low level of internal organisation is firm heterogeneity. Firm heterogeneity in the sense of an interplay of leaders and followers allows in particular for an evolutionary process in the accumulation of knowledge. To escape competition by innovation is a strong driver of growth, as Joseph Schumpeter emphasised.[234]

The beneficial effects of firm heterogeneity in an international setting have been worked out in what is called the new new trade theory. An unsympathetic side aspect of the new new trade theory is that the intensity of competition feeds back on locational decisions. To act out of a less contested market when selling on a highly disputed market confers firms an advantage. A bias in competition policy when it comes to decide on the priority ordering by which alleged infringements of the competitive order are investigated may therefore find a justification. Dominant firms run on foreign markets a higher risk of being the object of investigations (Microsoft is regularly targeted by the EU!). Also charges in M&A cases can as said have a pro domo bias. Furthermore, ministerial allowances overruling decisions by competition authorities will regularly serve national champions but this comes at some costs: they discredit a country in the community of competition authorities.

Another aspect that needs to be noted is that the empirical results obtained by the exponents of the 'new new' trade theory[235] hollow out the very fundamentals on which their models build. The tendency that an ever smaller number of firms enters with a more and more selective range of products foreign markets makes it the more and more unlikely that companies react only to market averages and not to the strategies of their single competitors. While it may be questioned whether this tendency towards an emergence of oligopolistic market structures is entirely new, the sad fact is that the more perfect competition and monopolistic competition loose out as a market form, the less the opening up of the economy to foreign competition by further dismantling obstacles to trade is a definite answer to promote competition. Competition policy (re-)assumes a role.

The next two sections will consider whether action by national authorities is sufficient to preserve a competitive order in a world with leading global firms or whether there is a need for coordinating market surveillance for competitive purposes by way of an international agreement - if not a common surveillance authority as in the EU?

3 Competition policy by way of competition legislation: The case of an oligopolistic retail sector

The constitutional order prevailing in the second half of the last century named as an area where the freedom of contract does not necessarily need to be respected the area of competition legislation. The ruling of the court in St.Gallen quoted above interestingly stated already in 1919 that there may be a need to interfere in the free interplay of economic actors in order to prevent private tendencies to monopolisation, the latter infringing the public interest. This ruling points into a modern direction where the presence of competition legislation - while possibly infringing the individual freedom of contract – is seen as constitutive of a market economic system and not as an intrusion into what should be a 'laisser faire'-world. While we share the modern view, it cannot be denied that authorities exercise large discretion in applying competition legislation. Excessive interference in the functioning of markets is not excluded.

It was only in 1962 when Switzerland adopted a first law on cartels.[236] A first revision of this law was debated for more than a decade and only in the two consecutive reforms of 1985 and 1995, a legislation was introduced comprising all three elements of a modern cartel legislation: The prohibition of cartels, the penalization of the abuse of a dominant position and a control of mergers and acquisitions. With respect to cartels, the Swiss law is up until today based on the principle of abuse and not on the principle of prohibition with exemptions. This reminiscence to the strong cartelist tradition in Switzerland should not be overestimated in its material impact, however. The scope of exemptions can be made very large

Einzeller, uns sinnlos jahrmillionenlang teilend, die Erde mit einem Brei bedeckend. Quote according to the publication „Freidenker", Band 72 (1989), Heft 5. Translation by the author.

[234] See Chapter 14 in the underlying publication on "Schumpeterian Growth"

[235] Melitz, Marc J. (2003): The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity, Econometrica, vol. 71(6); Melitz, Marc J. and Gianmarco I. P. Ottaviano, 2008. Market Size, Trade, and Productivity, Review of Economic Studies 75(1), Oxford University Press

[236] A rudimentary form of competition legislation existed since 1896 in the form of court rulings dealing with boycotts associations pronounced against non-members. The barely effective protection of outsiders based on the article on personal integrity in the Swiss "code civil".

and, if not, the resulting restrictions on how to organise a business may become too interventionist. More important is whether competition authorities are determined to exercise the power the law confers to them, whether they are supported by the courts and whether the executive branch of the government does not override rulings by ministerial allowances granted based on an alleged overall economic interest of the country.

Modern competition policy favours the "more economic approach". In merger cases, e.g., decisions are no longer based on structural characteristics such as market shares and concentration indices only, but on all three elements in the chain 'structure – conduct – performance', the latter chain no longer being understood as a one-directional chain of causality. The price in approaching economic reality is a loss in legal certainty, however. Industrial organisation is as a science far from being capable of forecasting competitive outcomes with sufficient reliability and the ensuing room for discretion allows to add a political dimension to decisions in competition cases. Of the three pillars in competition legislation, mergers in oligopolistic markets and the abuse of a dominant market position are more affected by uncertainties about the limitations government interference should know than the ordinary cartel agreements on prices and quantities. The economic science knows limits in answering on objective grounds questions such as the following: Is a merger necessary to earn sufficient money to sustain R&D activity, as the involved companies argue, or is the true motive for the merger simply that to add market shares results in better prices with no or even a negative impact on innovation? In global merger cases, the involved national authorities may each give a different answer. In the rest of this section, we will therefore concentrate on oligopolistic markets. These cases are the most likely to raise controversy over an inadmissible trans-border dimension of rulings by competition authorities.

Confronted with an oligopolistic market, competition authorities are in a poor position. Recent research proved that when market participants anticipate that Cournot pricing will be played among the oligopolists they are best served to act as if Cournot pricing is the effective market form. When they anticipate that Stackelberg competition will be played, then they should act as if Stackeberg competition is the rule of the game. We have a self-fulfilling prophecy. Furthermore, when capacity can be pre-ordered and sold in advance of the transaction period, Cournot price formation converges to Bertrand price formation, a very competitive form of pricing. We consider the results of these particular economic models as revelatory for where the theory of market outcomes in oligopolies stands. Numerous factors shaping the behaviour of agents can be identified. Some conclusions regarding what the optimal behaviour of agents would be can be drawn provided the exact framework of the game participants in the market play can be assessed. In reality, market participants have more behavioural parameters at their disposal than can be modelled and it may well be the case that at some point of time an agent changes attitudes and thereby changes the rules of the game, making any predictions even more uncertain.[237]

The question now is how the open outcome in oligopolistic markets relates to the opening up of markets across national borders and to globalisation. The best that can be said is that foreign firms entering a market are tantamount to add a new player to the game with different risk attitude, information, size and customer relations. Already the fact that a player is added to the game is essential. Reinhard Selten (1973)[238] became

[237] A telling example is provided by the Swiss retailer MIGROS. In the early years of its existence (before WWII), MIGROS was heavily boycotted by the cartels that were dominating the Swiss economy at these times. This induced MIGROS to set up its own production facilities and to copy leading consumer products by its own brands. In recent decades, MIGROS sometimes decided to add leading branded products to its shelves but regularly refrained from generalizing such strategies across all product groups. For the outside observers, the explanation for these changing attitudes regarding foreign brands resides rather in the person of the CEO and the role the own industry plays in the board of the company than in factors external to the company. Whether producers of branded products have only Coop and the competitive fringe at disposal for channelling their products to the ultimate customer or whether they have 'in store'-competition with the own brand of MIGROS of course changes substantially the rules of the game. Considering that the two retailers MIGROS and Coop hold often each 40% of the market in single goods, this indeterminateness in the behaviour of one of the two retailers matters.

[238] Selten, Reinhard (1973): A simple model of imperfect competition where four are few and six are many, International Journal of Game Theory, Volume 2, Issue 1, pp 141-201, December

famous for having published a paper showing why "four are few and six are many". The argument is that coordination among oligopolists breaks down when the number of players increases. Under the conditions of his model the threshold is at five players. In Swiss retailing, the merger of Migros and Denner and the acquisition by Coop of a significant part of the activities of Carrefour in Switzerland can be understood as an attempt to keep the number of players constant when ALDI and Lidl decided to enter the Swiss market.[239] The uncertainties created due to differences in the risk attitude, information, size (as a purchaser) and customer relations of the new entrants added to the readiness of the two dominant retail firms in Switzerland to engage in the acquisition of competitors in spite of the fact that this exposed them to a ruling of the competition authority. They now have to ask the competition authority for approval whenever they intend to acquire a new company, also a very small one.

Possibly, when the mergers had been prohibited, the oligopolists' game would have broken down, and retailing in Switzerland would have evolved towards the situation in Germany with its very contested retail sector, the latter falling also under specific legal provisions regarding the admission of M&A. But it also holds true that attempts to find a foreign buyer for Denner failed, so that the number of competitors may truly be a market outcome. In commenting this decision, one has to consider that while the two genuinely Swiss retailers are huge in the domestic market, they have due to the size of the country only small buying power in markets where global brands predominate, to the detriment of the Swiss customer. An increasingly global dimension of consumer goods' markets and how important the leading Swiss retailers and their direct competitors in foreign ownership are on these thus also had its influence although merger cases in an essentially national market were examined.

As indicated at the outset of this chapter, competition legislation applies where companies have their sales, not their seat. This is not a problem as long as the delineation of markets occurs along national borders. This will usually be the case in retailing. Foreign companies have to accept the resulting market entry conditions. They may claim, however, that procedures respect the principles of transparency, non-discrimination and procedural fairness. More delicate, mergers can also raise questions with respect to activities having a global scope, such as R&D efforts. This was e.g. the case when Pfizer acquired the Pharmacia Group. The Swiss competition authority ordered that Pfizer Inc. and Pharmacia Corp. sell the product "darifenacin" to a third party and dispose of Pharmacia's rights for development and commercialisation of the apomorphin-hydrochloride nasal spray for the treatment of erectile dysfunction.[240] The addition of such constraints could become a problem when imposed by authorities responsible for markets of a size the merging companies can difficultly give up. In practice, the merging companies will have to conform to the more or less independent rulings of the authorities in charge of the most important markets, currently the US and the EU, while the competition authorities of the other nations should align their decisions in the sense that they respect the economic freedom of the merging companies and let them submit proposals for corporate restructuring which avoid a chicken and egg situation. To avoid the emergence of possibly conflicting decisions by establishing a world competition authority is beyond what is conceivable under present geo-political interests and circumstances (see also the digression on strategic trade policy in Chapter 10 of the underlying publication). To coordinate time frames for decision taking by the competition authorities involved in a merger case would already be an achievement.

4 Is there a need for an international agreement on competition policy?

After the turn to the 20th century, the economies of the industrialised world got increasingly under the influence of large industrial trusts. And these trusts increasingly also agreed on dividing up the global market. An example in case was the Phoebus cartel, created on 23 December 1924 "under the sparkling bulbs of Christmas lighting"[241] in Geneva by Germany's Osram, the Netherlands Philips, France's Compagnie des Lampes, and the subsidiaries and licensees of General Electric from the US, including e.g. also the Japanese manufacturer Tokyo Electric. This cartel became famous for having agreed on cutting the life expectancy of an electric bulb from up to 2000h to 1000h. This first known example of engineered obsolescence of a product was enforced by fines manufacturers had to pay when samples of their

[239] The mergers were initiated by Denner and Carrefour, seeing their market chances dwindle.

[240] As suggested below in the text, the charges were in line with the commitments the merging companies made to the European Commission (Case No COMP/M.2922) under schedules IV and V

[241] Krajewski, Markus (2014): The Great Lightbulb Conspiracy, IEEE spectrum, Volume 51, No.10, p.56-61

production sent to the Geneva based Phoebus S.A. displayed a longer burning time than agreed.

In these years, cartels were not necessarily seen as negative. At the International Economic Conference held under the auspices of the League of Nations in May 1927[242] in Geneva, Louis Loucheur, the head of the French delegation, saw the transnational division of markets as a way to dismantle protectionist tariffs and to realise an industrial organisation in depressed Europe capable of facing the dynamic economy of the US.[243] He was opposed by Gustav Cassel, professor of economics at Stockholm University, and famous up until today for his work in the area of monetary theory. These conflicting views possibly translate deeper and long lasting convictions of nations about appropriate economic policy: In 1931, Scandinavia's 'North European Luma Co-op Society' produced and sold bulbs at a considerably lower price than Phoebus' members, economic and legal threats staged by Phoebus against Luma not achieving the desired effect. On the other hand, the French government sticks up until today to the idea of creating national champions, as the Sanofi-Aventis merger testifies.[244]

After WWII, the US exported their economic order and convictions, anti-trust legislation not constituting an exemption in this regard. Indeed, the stillborn International Trade Organisation (ITO) negotiated in Havana in 1948 included provisions on restrictive business practices. At that time, the memory of the damaging effects of international cartels during the 30' was still alive. Following the failure of the ITO, competition did not figure in the GATT, in part because governments were often keen to promote economic concentration with the idea to enhance international competitiveness by the constitution of national champions.

With the growth of global production there has been an increased debate on the need for an international agreement on competition. The point made is that globalisation means that markets are global but competition authorities are still largely limited by the borders of national jurisdictions.[245] The Singapore Ministerial Conference of the WTO (1996) set up the Working Group on the Interaction between Trade and Competition Policy "to study issues raised by Members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework". At the WTO Ministerial Conference in Doha (2001), Ministers "recognized the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area". They instructed the Working Group to focus, until the WTO Ministerial Conference in Cancún (2003), "on the clarification of: i) core principles, including transparency, non-discrimination and procedural fairness; ii) provisions on hard-core cartels; iii) modalities for voluntary cooperation; and iv) support for progressive reinforcement of competition institutions in developing countries through capacity building". In the "July 2004 package" adopted 1 August 2004, the WTO General Council decided then that the issue of competition policy "will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha

[242] D'Alessandro, Michele (2007): Seeking governance for world markets - The League of Nations between corporatism and public opinion 1925-1929, contribution to the XIth Annual Conference of the European Business History Association, Geneva, 13-15 September, 2007

[243] Hidvégi, Mária (2011): Internationale Kartelle und der europäische Wirtschaftsraum der Zwischenkriegszeit, Essay, Clio Online, Themenportal Europäische Geschichte, www.europa.clio-online.de/2011/Article=482

[244] Sanofi-Aventis was formed in 2004 when Sanofi-Synthélabo acquired Aventis. In early 2004, Sanofi-Synthélabo had made a hostile takeover bid worth €47.8 billion for Aventis. Initially, Aventis rejected the bid because it felt that the bid offered a value inferior to the company's due share value. The board of Aventis went so far as to enact poison pill provisions and to invite Novartis to enter merger negotiations. The three-month takeover battle ended when Sanofi-Synthélabo launched a friendly bid of €54.5 billion in place of the previously rejected hostile bid. The French government played a strong role, desiring what it called a "local solution", by putting heavy pressure on Sanofi-Synthélabo to raise its bid for Aventis and for Aventis to accept the offer and by rejecting Aventis' poison pill proposal (see e.g. http://en.wikipedia.org/wiki/Sanofi).

[245] Heydon, Ken and Steve Woolcock (2007): The Evolution of Free Trade Agreements negotiated by the US, EU, EFTA, Japan and Singapore : strategies, content and comparisons, in Peter Balastèr, Chantal Moser (eds.): Sur la voie du bilatéralisme: enjeux et consequences (volume 1), Strukturberichterstattung Nr. 36/1, Berne (SECO)

Round". Since then the Working Group is inactive.[246]

Some general considerations are needed to better understand the issues at stake. A first consideration refers to the role of the WTO. As the mnemonics "TRIM" and "TRIPS" indicate, the WTO is in charge of establishing rules at the intersection of trade and investment or trade and intellectual property rights, the TRIPS agreement does not set up an international organisation handing out patents with global validity. It is therefore doubtful whether the WTO would be the appropriate place to establish an authority capable of reviewing mergers relevant for global markets. Business would eventually favour such a one-stop solution, since today, merger projects have to be submitted to the authorities of all countries where the merging companies achieve a turn-over beyond the thresholds as laid down in national law. It would be more in line with the principles of the WTO, however, if a competition agreement would set minimum standards for national competition legislation and – hardly ever mentioned, but relevant if one thinks about the transatlantic dispute over the Boeing-McDonald Douglas merger case - eventually mechanisms to prevent the escalation of controversial decisions of national authorities in anti-trust law into trade wars. A second consideration refers to the guiding principles and main enforcement mechanisms of competition law. The stock of basic regulations competition legislation should comprise is not controversial, the three pillars are to fight hard-core cartels, to oppose the abuse of a dominant position on a market and to establish a control of mergers. The problem resides in the fact that the notion of "tests" favoured by cartel lawyers is not accessible to an economist trained in econometrics. Although the "more economic approach" favours the use of econometric estimation methods to achieve a more objective assessment,[247] competition authorities dispose of a lot of discretion when taking decisions. There is also a lot of discussion regarding reasons such as increased economic efficiency that make an agreement among competitors or a merger admissible although it infringes the articles circumscribing harmful business practices. Due to the discretion exercised, the legitimacy of a competition authority is crucial. Furthermore, escape clauses are also found in competition legislation, i.e. national interest may allow for the admission of a merger by political authorities such as a ministry of economics. In this vein, export cartels were regularly admitted (although it was hard to believe that the firms exporting would not at the same time also discuss over the national market …). It is therefore not for nil that in competition legislation the effects principle prevails. Mergers are not reviewed by the competition authorities of the countries where the merging companies have their headquarters (legal seat) but by the authorities of where these companies have their markets.

Given the national aspirations indicated above, this allocation of decisional power favours pro-competitive rulings but has also the potential of raising disputes over the extra-territorial application of national law. If a merger is tolerated provided that the merging companies sell off parts of their business, competition legislation necessarily interacts with industrial policy. The risk is considerable that the burden of adjustment will be placed on foreign subsidiaries. An additional aspect is private enforcement. On one hand, if possible in most economically important jurisdictions (what is not really the case), action by competitors might substitute for treaty-based public intervention. However, if e.g. a judge in a US District Court decides on coercive measures in a hard-core cartel investigation we may again have the problem of an extra-territorial application of national (case) law, difficultly tolerable by the foreign country. The instructions given in Doha to the working party are to be seen against this background. The working party was requested to provide clarification of: i) core principles, including transparency, non-discrimination and procedural fairness and iii) modalities for voluntary cooperation.

As a third consideration, the need for cooperation on the one hand and the simultaneous restriction of the WTO to topics having a bearing on trade on the other raises the question whether there are other fora within which competition policy can be put into effect globally. Three institutions deserve mentioning. Based on an initiative by the USA, in 2001, the International Competition Network ICN was founded. The ICN provides competition authorities with a specialized yet informal venue for maintaining regular contacts and addressing practical competition concerns. The ICN's mission statement is "to advocate the adoption of superior standards and procedures in competition policy around the world, formulate proposals for procedural and substantive convergence, and seek to facilitate effective international cooperation to the benefit of member agencies, consumers and economies worldwide."

[246] http://www.wto.org/english/tratop_e/comp_e/history_e.htm

[247] Econometrics can e.g. be used to estimate substitution elasticities among product categories in order to delimit markets, but no competition law would lay down a certain elasticity as a formal threshold for delineating markets.

Today, more than 100 competition authorities from all continents are members of the ICN. A second institution to be mentioned is the Committee on Competition Law and Policy CLP within the OECD. It is geographically more focused since primarily authorities of industrial nations attend. In the latter, the two aspects that decisions in competition cases are to be taken by an agency not receiving case by case instructions from the actual government in place and that these decisions are subject to review by an independent judiciary body are possibly better respected than in other world regions. As the name of the Committee indicates, the legislative dimension is important in the work of the CLP so that representatives from ministries in charge of elaborating new competition laws also attend. The exchange of confidential information obtained by competition authorities and the use the other country may make of such information when exchanged is subject of an ongoing debate, since the requirement of reciprocity may easily be infringed when it comes to its practical application and national interests (i.e. profitable business of one's national companies in the respective market) are seen at risk. Regularly, the work of the CLP is shared with countries not member of the OECD. A privileged forum for such exchange is provided by the UNCTAD where, each year, the Intergovernmental Group of Experts (IGE) on Competition Law and Policy meets. It proceeds by way of voluntary peer reviews of national competition laws and policy, by round-tables on specialized competition topics, and by assistance and capacity-building activities taking place in different world regions. This purpose serve i.a. the UNCTAD Model law on competition and the Handbook on competition legislation while the United Nations Set of Principles on Competition provides one basis for intergovernmental consultations.

Consequently, the absence of an international agreement on competition policy in no way means that global business can deploy its activity in an unchecked manner. The costly cases of cartel litigation in which multinationals are involved proves to the contrary. The authorities in the affected countries can most of them time adequately handle the unilateral behaviour of large companies and collusive practices on their domestic markets. Charges in merger cases raise some additional problems. The major concern in all disputes remains the fairness (i.e. impartiality) with which national authorities including their governments exercise their power. Which investigations to launch and when a ministry shall grant a waiver from the strict application of competition legislation are among the most delicate issues. Finally, it is worth mentioning that a forth pillar of competition policy, namely government aid, is part of the regulatory framework established by the WTO. In this book, Chapter 1 on agricultural support, Chapter 2 on export processing zones, Chapter 4 on antidumping and safeguards and Chapter 9 on public procurement (the latter only in a limited and indirect way) offered an opportunity to present information by which the effectiveness of the WTO in intervening against government aid may be gauged.

Chapter15
The Scope and Functioning of International Organisations

A presentation of globalisation would remain incomplete without a chapter devoted to the global fora within which countries can find solutions for their common concerns. This is the scope of this and the following chapter.[248] We will not cover private organisations that serve a similar purpose.[249] So, neither NGO's nor e.g. the international associations of employers' organisations or unions will be portrayed in spite of the fact that the latter have a defined role in the ILO (see Chapter11). The sheer number of NGO's excludes such a presentation.[250] Also within the public sphere, we will concentrate on those international organisations that authored documents or deployed activities cited in this text.

The chapter will first characterise international organisations, of which many evolve under the umbrella of the UN (i.e. they belong to the 'UN family'). We thereby emphasise the origin of the organisations mentioned in this book. Moving more in the field of international economics, we will in a second stepocus on the international organisations that extend credit to their member states and on their instruments. The third subsection then shows the engagement these funds have taken towards a single country, Kenya having been chosen for these illustrative purposes, in accordance with the choice made in Chapter 13 of the underlying publication.

1 International Organisations in general and the UN family

According to the law of nations, an international organisation is an association created by at least two States or other subjects of international law, which is permanent, operates usually across national boundaries and serves purposes that extend beyond national interests. An essential feature of such an organisation is that it has at least one organ through which it acts. Currently, about 250 international organisations are active worldwide.[251]

It is not always easy to operate a distinction between an international organisation, an international agreement and an international conference. An example in case is provided by the activities in the field of security policy at which we look in the next three paragraphs. We then turn to the family of United Nations organisations before presenting the affiliation of the conferences responsible for worldwide climate policy.

Security Policy – the OSCE, the export control regimes and disarmament

To illustrate the open point regarding the organisational forms in which nations cooperate we first consider the Organisation for Security and Cooperation in Europe.[252] The OSCE traces its origins back to the détente phase of the early 1970s, when the Conference on Security and Co-operation in Europe (CSCE) was created to serve as a multilateral forum for dialogue and negotiation between East and West. Meeting over two years in Helsinki and Geneva, the CSCE reached agreement on the Helsinki Final Act, which was signed on 1 August 1975

[248] To alleviate this chapter and to keep it focused on international help granted to facilitate the economic evolution at the country level, a substantive part of the presentation on the scope and functioning of international organisation was moved to Chapter 16 where it figures under the heading: 'The institutional framework shaping the global financial system'. There, we look for a second time at the IMF, but now from the point of view of global financial stability, also a concern of the BIS. The OECD also figures there due to the organisation's instruments relevant for the free movement of capital although the scope of activities of this organisation is much larger. Finally, we recall that the institutional features of the WTO as another outstanding international organisation were already presented in a section in part III of Chapter 1.

[249] The case study in the underlying publication is devoted to a private development organisation.

[250] The ECOSOC through its Committee on NGOs has granted consultative status to some 3000 private sector organisations (see http://csonet.org/content/documents/e2013inf6.pdf)

[251] Definition according to Union of International Associations (ed.), *Yearbook of International Organizations*, Vol. 5, 43. Munich, 2006, p. 33.

[252] The following text is from the OSCE homepage, except the indications on the three baskets.

The Final Act.[253] was made up of three parts: [254]

1st basket: *Confidence-building measures and certain aspects of security and disarmament*

2nd basket: *Cooperation in the field of economics, science and technology and the environment*

3rd basket: *Cooperation in humanitarian and other fields.*

Until 1990, the CSCE functioned mainly as a series of meetings and conferences that built on and extended the participating States' commitments, while periodically reviewing their implementation. However, with the end of the Cold War, the Paris Summit of November 1990 set the CSCE on a new course. In the Charter of Paris for a New Europe, the CSCE was called upon to play its part in managing the historic change taking place in Europe and responding to the new challenges of the post-Cold War period. This led to the organisation's acquiring of permanent institutions and operational capabilities.[255] As part of this institutionalisation process, the name was changed from CSCE to OSCE by a decision of the Budapest Summit of Heads of State or Government in December 1994.

A second example in case are non-proliferation agreements.[256] The four relevant activities in the field of export controls are not even an international treaty although enforcement is quite strict. The Australia Group (dealing with chemical and biological weapons), the Nuclear Suppliers Group (dealing with nuclear weapons), the Missile Technology Control Regime (dealing with ballistic missiles, cruise missiles, UAV (drones)) and the Wassenaar Arrangement (dealing with conventional arms and dual use goods and technologies) are – as the latter is called – arrangements with the common objective to prevent the proliferation of media of mass destruction and technologies suited to build such weapons or to accumulate excess military capabilities. The decisions taken based on the lists of goods each arrangement enumerates in its appendices are wholly in the responsibility of the ca. 40 participating states. They only mutually inform each other on the decisions taken. Export permits are granted in accordance with the risks countries present to the exporter nations' security. While among the 40 participating states, exports of delicate goods and services fall typically under a general allowance, for exports to other nations normally a permit needs to be obtained on a case by case basis. One hardly publicly declared but central enforcement mechanism is that countries that do not stick to the consensus of the countries cooperating within these arrangements risk that their industries are cut off from the supply of the corresponding goods and technologies. The relevance of these regimes for private business is revealed by the fact that in Switzerland some 10'000 permits for exporting, importing, fabricating or dealing with weapons and dual use goods are granted each year.

Distinct from the export control regimes – also with regard to their organisational form -, but active in the same field are the institutions seeking to abolish the ABC weapons. The Chemical Weapons Convention is a binding international treaty aiming at the global proscription of chemical weapons (and not only their international trade). In force since 1997, 188 countries are meanwhile part of the treaty. The enforcement of the agreement is conveyed to the Organisation for the Prohibition of Chemical Weapons (OPCW) in The Hague. In this area, we therefore have simultaneously an international treaty and an international organisation. The Biological Weapons Convention is the parallel treaty aiming at the proscription of biological weapons. In force since 1975, 163 countries have by now signed this treaty. The agreement also prohibits the development, production, storage and exchange of biological weapons and obligates signatory states to destruct eventual substances or to con-

[253] The Accords' "Declaration on Principles Guiding Relations between Participating States" (also known as "The Decalogue") enumerates the following 10 points: I. Sovereign equality, respect for the rights inherent in sovereignty; II. Refraining from the threat or use of force; III. Inviolability of frontiers; IV. Territorial integrity of States; V. Peaceful settlement of disputes; VI. Non-intervention in internal affairs; VII. Respect for human rights and fundamental freedoms, including the freedom of thought, conscience, religion or belief; VIII. Equal rights and self-determination of peoples; IX. Co-operation among States; X. Fulfillment in good faith of obligations under international law.

[254] In particular, the 3d basket stimulated the human rights movement and the consequent political transformation in the former centrally planned economies in the east of Europe, see: http://www.spiegel.de/spiegel/spiegelspecialgeschichte/d-58508503.html

[255] An example are the admission of observers when larger military manoeuvres take place.

[256] The following information is taken from the homepage of the Swiss State Secretariat of Economic Affairs.

vert them into a form suitable for a civilian utilisation. The military engagement of biological substances is not part of the treaty but the treaty executes the Geneva Protocol of 1925 stipulating the prohibition of these weapons in the law of nations. Opposite to the Chemical Weapons Convention, the Biological Weapons Convention is lacking a binding enforcement mechanism. Countries decided to place confidence building measures only on a voluntary basis, and not all signatory states participate in these. In the area of nuclear threats, we have the International Atomic Energy Agency in Vienna (IAEA, not to be confused with the IEA in Paris (see Chapter 16)). The purpose of the organisation is to promote the peaceful utilisation of nuclear energy. Among the six major IAEA departments - management, nuclear sciences and applications, nuclear energy, nuclear safety and security, technical cooperation, and safeguards and verification, the last plays an important role in global security policy by tracking the utilisation of nuclear substances on the spot. Since nuclear plants are also run by private sector firms, the activities of the IAEA are - similarly to the ones of the other institutions mentioned in these paragraphs - of direct relevance for single companies and do not only concern the public authorities. If inspections rise serious concerns in the sense that a country could develop nuclear weapons – an activity prohibited by the Treaty on the Non-Proliferation of Nuclear Weapons[257] – the IAEA Board will report this to the UN Security Council and the latter may then decide measures such as an embargo.[258] [259]

The UN Family[260]

The most prominent example of an international organisation are the United Nations (UN). Founded in 1945, the United Nations (UN) continued the idea of the League of Nations founded in 1919 under the impression of the disaster of WWI. The UN founding States claimed that the new organisation would overcome the weaknesses of the League of Nations in structure and powers which, according to a frequently expressed view at the time, had not been appropriate to prevent WWII. Whether the UN lives up to these expectation is open.

There are three bodies at the top level of the UN, the Security Council and the General Assembly plus the hardly known ECOSOC. The first deploys activities mainly in the field of security policy (we refrain on giving further details on peacekeeping missions, sanctions inflicted on particular countries a.s.o.). The well-known particularity of the Security Council is the veto power the atomic powers hold. The second body, the General Assembly, is a forum for political debates in general. This finds its expression in the six committees within which the members of the General Assembly also meet, the second e.g. being devoted to economic and financial affairs. With regard to the topic of this book, the adoption of the Millennium Development Goals by the General Assembly deserves mentioning (see box below). The third body, the Economic and Social Council primarily serves as the organ where the activities of the UN special organisations that all deploy their activity in a particular field might be coordinated. The ECOSOC has a reputation of inefficiency, however. Furthermore, we have at the top level the International Court of Justice in

[257] The Treaty on the Non-Proliferation of Nuclear Weapons entered into force in 1970. 190 states have joined the treaty. The treaty recognizes five states as nuclear-weapon states: the US, Russia, the UK, France, and China (also the five permanent members of the United Nations Security Council). India, Pakistan and Israel never signed the treaty and North Korea withdrew its signature. According to the Arms Control Association, the guiding principle of the treaty is that non-nuclear-weapon states agree never to acquire nuclear weapons and the NPT nuclear-weapon states in exchange agree to share the benefits of peaceful nuclear technology and to pursue nuclear disarmament aimed at the ultimate elimination of their nuclear arsenals.

[258] Opposite to the case of the Iraq in the 1980ies when trade in quasi all goods was prohibited, putting thus a disproportionate burden on the majority of the population, in the case of Iran, sanctions aim at hitting the leading circles (“smart sanctions”). Beyond a ban on arms exports to the country, exponents of the country are prohibited from travelling abroad or from entering into financial relations with banks abroad.

[259] Switzerland, as a neutral country, decided to apply the embargos decided by the UN already before the country became a full member of the United Nations. The country is ready to apply also the embargos decided by the OSCE and the law leaves open the possibility to adhere to embargos decided “by Switzerland's most significant trading partners and which serve to secure compliance with international law, and in particular the respect of human rights“. In other circumstances, Switzerland considers that in case of conflict a neutral country should limit trade by appropriate control measures to the volume before the conflict emerged (i.e. the ‘courant normal’).

[260] http://www.un.org/en/aboutun/structure/index.shtml

The Hague.[261] The UN-Charter further mentions as organs of the organisation the UN Secretariat and the UN Trusteeship Council. The latter is inactive since 1994, when Palau, the last trust territory, was released in independence.

The Millennium Development Goals

On 8 September 2000, following a three day Millennium Summit of world leaders at the headquarters of the United Nations, the General Assembly adopted the Millennium Declaration. All 189 United Nations member states at the time and at least 23 international organisations committed to help achieve the following Millennium Development Goals by 2015, namely:

1. *To halve the number of undernourished people*
2. *To achieve universal primary education*
3. *To promote gender equality and empower women*
4. *To reduce child mortality*
5. *To improve maternal health*
6. *To combat HIV/AIDS, malaria, and other diseases*
7. *To ensure environmental sustainability*
8. *To develop a global partnership for development.*

Each goal has specific targets and indicative time limits for achieving those targets of which we reproduce here the essential components: The objective of goal 1 is to halve, between 1990 and 2015, the proportion of people living on less than $1.25 a day, while according to goal 2 by 2015, all children (girls and boys) can complete a full course of primary schooling. Goal 3 builds on ratios of the two sexes in education up to the tertiary level, on the share of women in wage employment in the non-agricultural sector and on the proportion of seats held by women in national parliament. Goal 4 is instrumented by the under-five mortality rate and immunisation against measles, goal 5 by the proportion of births attended by skilled health personnel, by antenatal care coverage and by the presence of family planning. The achievement of goal 6 is assessed based on the prevalence particularly among the young of HIV, malaria and tuberculosis, the application of corresponding precautionary measures and access to adequate treatment. Goal 7 builds on achieving by 2010 a significant reduction of biodiversity loss, measured by the proportion of land area covered by forest, by CO_2 emissions (total, per capita and per $1 GDP (at PPP)), by consumption of ozone-depleting substances, by the proportion of fish stocks within safe biological limits, by the proportion of total water resources used, by the proportion of terrestrial and marine areas protected and by the proportion of species threatened with extinction; a complementary objective under the not immediately intelligible goal 7 is to halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation. Combined with a commitment to good governance, under the non-self-explanatory goal 8 in particular the special needs of the Least Developed Countries (LDCs) are addressed (includes: tariff and quota free access for LDC exports; enhanced programme of debt relief for the highest indebted poor countries and cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction); other elements under goal 8 are to provide access to affordable, essential drugs in developing countries and to make the benefits of new technologies, especially in information and communications broadly available.

Progress towards reaching the goals has been uneven across countries. The major successful countries include China (whose poverty population declined from 452 million to 278 million) and India. According to the World Bank, Millennium Development Goal 1 was achieved in 2008 mainly due to the results from these two countries and the rest of East Asia.

From a financial point of view, the Multilateral Debt Relief Initiative was the most important. 41 countries qualified for this initiative of the G8-finance ministers, potentially worth some US-$ 70 bio. in debt relief. These highest indebted poor countries saw their ratio of indebtedness cut to 150% of export revenues and 250% of government revenues if the World Bank and, where applicable, the African Development Bank together with the IMF saw sufficient commitment to engage the funds no longer needed to serve the debt with these multilateral organisations in programmes serving the Millennium Development Goals.

[261] The jurisdiction of the Court comprises all cases which the parties (only States may be parties) refer to it and all matters specially provided for in the UN-Charter or in treaties and conventions in force.

In 2015, an assessment of the attainment of the Millennium Development Goals took place[262] and a renewal occurred, the post-2015 development agenda, defining sustainability goals.[263] The UN's Press Release referring to the MDGs states that "enormous progress has been made towards achieving the MDGs. Global poverty continues to decline. More children than ever are attending primary school. Child deaths have dropped dramatically. Access to safe drinking water has been greatly expanded. Targeted investments in fighting malaria, HIV/AIDS and tuberculosis have saved millions", and continues: "The MDGs prove that goal setting can lift millions of people out of poverty, empower women and girls, improve health and well-being, and provide vast new opportunities for better lives."

While there were 8 MDGs, there are now 17 Sustainability Goals and they are broken down in a much larger number of single targets of which far less are quantifiable than this was the case with most MDGs. Due to this plethora of things that should happen up to the year 2030 we cannot reproduce here the Sustainability Goals. It remains to be seen which will become the key targets among these objectives in the political reception and public perception and whether comparable progress as with regard to the MDGs can be achieved.

Abstracting from these core bodies of the UN, the rule for international organisations is that they deploy their activity in a particular field. The number of specialised organisations has especially developed after the end of World War II.[264] The rapid progress of civilization created a compelling need for the World's nations to closer cooperate in almost all fields of human activity.

Above, we have already discussed the most prominent organisations active in the field of security policy.[265] We next turn to the area of social affairs. This is the realm of the Special Agencies of the UN. The latter preserve a high degree of responsibility of their own since they typically build up legitimacy for their actions in annual conferences of the member states at the headquarters of these organisations. The UN homepage lists under the heading of 'Specialized Agencies of the United Nations, Related Organisations and Secretariats of Conventions' the following organisations:[266] [267]

[262] See http://www.un.org/millenniumgoals/

[263] See http://www.undp.org/content/undp/en/home/mdgoverview/post-2015-development-agenda.html

[264] A first heyday experienced International Organisations in the second half of the 19th century, i.e. during the first wave of globalisation. The International Telecommunication Union (ITU) of 1865 and the Universal Postal Union (UPU) of 1874 exist to this day largely unchanged. The World Meteorological Organization (WMO) e.g. originates from the International Meteorological Organization (IMO) founded in 1873. Precursor organisations exist in other areas such as the protection of intellectual property rights. Finally, the ILO created in 1919 is the only surviving agency of the League of Nations. The ILO was long better known by the French name of its permanent secretariat Bureau International du Travail (BIT), the latter fact also reflecting the changing importance of languages in the international sphere.

[265] The International Committee of the Red Cross (ICRC) is a private association under Swiss law. It qualifies as an international organisation not only by tradition, but also by the fact that a number of international treaties make reference to the ICRC. Not to have nations as its constituency may underscore its humanitarian vocation.

[266] Art. 57 of the UN Charter reads: 1. The various specialized agencies, established by intergovernmental agreement and having wide international responsibilities, as defined in their basic instruments, in economic, social, cultural, educational, health, and related fields, shall be brought into relationship with the United Nations in accordance with the provisions of Article 63. 2. Such agencies thus brought into relationship with the United Nations are hereinafter referred to as specialized agencies. Art. 63 of the UN Charter reads: The Economic and Social Council may enter into agreements with any of the agencies referred to in Article 57, defining the terms on which the agency concerned shall be brought into relationship with the United Nations. Such agreements shall be subject to approval by the General Assembly. 2. It may co-ordinate the activities of the specialized agencies through consultation with and recommendations to such agencies and through recommendations to the General Assembly and to the Members of the United Nations.

[267] We omitted in the table the Preparatory Commission for the Nuclear-Test-Ban Treaty Organization, the Convention on the Rights of Persons with Disabilities and the UN Convention to Combat Desertification.

Acronym	*Agency*	*located*	*established*
Specialized agencies of the United Nations			
FAO	Food and Agriculture Organization	Rome	1945
IAEA	International Atomic Energy Agency	Vienna	1957
ICAO	International Civil Aviation Organization	Montreal	1947
IFAD	International Fund for Agricultural Development	Rome	1977
ILO	International Labour Organization	Geneva	1946 (1919)
IMO	International Maritime Organization	London	1948
ITU	International Telecommunication Union	Geneva	1947 (1865)
UNESCO	UN Educational, Scientific and Cultural Organization	Paris	1946
UNIDO	UN Industrial Development Organization	Vienna	1967
UNWTO	World Tourism Organization	Madrid	1974
UPU	Universal Postal Union	Bern	1947 (1874)
WFP	World Food Programme	Rome	1963
WHO	World Health Organization	Geneva	1948
WIPO	World Intellectual Property Organization	Geneva	1974
WMO	World Meteorological Organization	Geneva	1950 (1873)
furthermore the Bretton Woods Institutions (regarding their status see also below).			
IMF	International Monetary Fund	Wash.DC	1945 (1944)
WBG	World Bank Group	Wash.DC	1945 (1944)
Related Organisations			
OPCW	Organisation for the Prohibition of Chemical Weapons	The Hague	1997
WTO	World Trade Organisation	Geneva	1995
Secretariats of Conventions			
UNFCCC	UN Framework Convention on Climate Change	Bonn	1992

Compared to these organisations, a number of commissions and programmes operating directly under the auspices of either the General Assembly or the ECOSOC are of similar importance. We mention here:[268]

UNCTAD	UN Conference on Trade and Development	Geneva	1964
UNEP	UN Environment Programme	Nairobi	1972
UNDP	UN Development Programme	New York	1965

The five regional commissions of the UN report also to the ECOSOC

[268] Other well-known bodies falling under this heading are the International Law Commission (ILC), the UN Commission on International Trade Law (UNCITRAL), the UN High Commissioner on Refugees (UNHCR), the UN Children Fund (UNICEF), the Commission on Population and Development or the Statistical Commission. For the Commission on Sustainable Development see below. We do not enlist here the bodies dealing with drug trafficking and similar criminal activities.

ECA	Economic Commission for Africa	Addis Abeba	1958
ECE	Economic Commission for Europe	Geneva	1947
ECLAC	Economic Com. for Latin America and the Caribbean	Santiago	1948
ESCAP	Economic and Social Com. for Asia and the Pacific	Bangkok	1947
ESCWA	Economic and Social Com. for Western Asia	Beirut	1973

These Economic Commissions have subsidiary bodies of their own. Among the activities of the Economic Commission for Europe, e.g., the Inland Transport Committee, known for the normalisation activities in the field of road vehicles (ECE norms) or the Conference of European Statisticians stand out. The ECE further hosts the secretariat for a number of conventions addressing trans-boundary environmental concerns. Finally, the Committee on Housing and Land Management acts as the regional branch of UN Habitat, the UN organisation discussing the development of human settlements.

A remark on the status of the European Union

As indicated, international organisations deploy their activity within a typical range confined by their statutes. An exemption with a very broad range of activities – beyond the UN-System- is the European Union. The EU holds the status as a subject of international law at least since the treaty of Lisbon where this view of its member states was explicitly laid down. More to the point, the EU and its predecessor organisations should be described as a super-national body of its own nature. The reason – beyond the broad scope of activities deployed and legal texts enacted by the EU and its institutions - are the many individual rights EU law conveys to the Union's citizens (and economic enterprises) against EU member states and eventually the EU itself. International Organisations such as the WTO or the Bretton Woods Institutions have nations as their actors. Only in a few instances, the rights and obligations member countries have according to the statutes of international organisations can be invoked by individual parties. In Switzerland, e.g., the legal texts adopted within the WTO help courts in interpreting national law, but as a rule they cannot be directly invoked by firms.

The heterogeneity of the institutional settings may be explained by the fact that the world's nations launched and launch initiatives at different moments in time under changing political circumstances and then often embed the common activity in a new, targeted forum. The relation of these initiatives to the UN remains to be defined (see e.g. the OSCE). Entrusting an existing international organisations is often not an option due to the alleged political affinity of these organisations and the fact that they have their well-established agenda and financing and therefore show considerable institutional inertia. Furthermore, the transition from a Conference Secretariat to a Treaty Secretariat to an International Organisation remains fluent and these institutional forms are often intermingled as we have seen in the area of export controls. This fact is further corroborated by the history and institutional setting of world climate policy to which we turn next, recalling thereby the content of Chapter 10 on the interrelation between globalisation and the environment.

The institutional framework for global climate policy

At the heart of global climate policy is the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol building on it. A landmark on the process leading to the adoption of these conventions was the conference held in Rio in 1992.

The Conference of Rio 1992, formally the *United Nations Conference on Environment and Development (UNCED)*, informally also known as the Earth Summit, linked the two topics of development and the environment and gave prominence to the notion of 'sustainable development'. 172 governments participated, with 116 sending their heads of state or government. Some 2'400 representatives of non-governmental organizations (NGOs) attended as well, with 17'000 people joining at the parallel NGO "Global Forum", who had consultative status. The conference had been prepared over several years and benefitted inter alia from contributions of UNCTAD, UNDP or the FAO. Before, the World Commission on Environment and Development, installed in 1983 as a commission of independent experts under the presidency of the Norwegian Prime Minister Gro Harlem Brundtland, had laid with the publication of ‘Our Common Future’ the groundwork for the convening of the 1992 Earth Summit and the adoption of Agenda 21, the Rio Declaration and to the establishment of the Commission on Sustainable Development. The Commission on Sustainable Development (CSD), reporting to the ECOSOC, then functioned up to 2012 as the body monitoring the outcomes of the 1992 Earth Summit.[269] However, the follow-up conferences (Rio+5 in New York, the World Summit in Johannesburg 2002 and Rio+20 in 2012) produced no comparable results to the Earth Summit of 1992 where the following documents were adopted: Rio Declaration on Environment and Development, anchoring the right of sustainable development, the Agenda 21, conferring the task of taking the necessary measures to achieve sustainable development to the national states, but also to initiatives of entities at the subnational level and to private organisations, furthermore the Forest Principles, giving without specific commitments voice to the concern of worldwide deforestation; moreover, important legally binding agreements were opened for signature, namely the Convention on Biological Diversity, the United Nations Convention to Combat Desertification and the Framework Convention on Climate Change (UNFCCC).

The *United Nations Framework Convention on Climate Change (UNFCCC)* is, as said, an international environmental treaty negotiated before and at the Earth Summit in Rio de Janeiro 1992. The objective of the treaty is to "stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system". The treaty provides a framework for negotiating specific international treaties (called "protocols") that may set binding limits on greenhouse gases. As of March 2014, UNFCCC had 196 parties. The parties to the convention met annually from 1995 on in *Conferences of the Parties (COP)* to assess progress in dealing with climate change.[270] In 1997, at the third COP, the Kyoto Protocol was adopted and established legally binding obligations for developed countries to reduce their greenhouse gas emissions. The 2010 Cancún agreements, adopted at the 16th COP, state that future global warming should be limited to below 2.0 °C relative to the pre-industrial level. The 20th COP in Peru in December 2014 continued the negotiations towards a renewed global climate agreement which was then effectively concluded in Paris in December 2015. One of the first tasks set by the UNFCCC was for signatory nations to establish national inventories of greenhouse gas (GHG) emissions and removals, which were used to create the 1990 benchmark levels for accession of Annex I countries to the Kyoto Protocol and for the commitment of those countries to GHG reductions. Updated inventories must regularly be submitted by Annex I countries. The UNFCCC is also the name of the United Nations Secretariat charged with supporting the operation of the Convention. The Secretariat, located in Bonn, Germany, and augmented through the parallel efforts of the Intergovernmental Panel on Climate Change (IPCC), aims to gain consensus through meetings and the discussion of various strategies.

The *Intergovernmental Panel on Climate Change (IPCC)* is a scientific intergovernmental body under the auspices of the United Nations. It was first established in 1988 by two United Nations organisations, the World Meteorological Organisation (WMO) and the United Nations Environment Programme (UNEP), and later endorsed by the United Nations General Assembly through Resolution 43/53. IPCC reports cover the scientific, technical and socio-economic information relevant to understanding the scientific basis of risk of human-induced climate change, its potential impacts and options for adaptation and mitigation. Thousands of scientists and other experts contribute to writing and reviewing the reports on which the IPCC bases its assessments. The IPCC reports contain a "Summary for Policymakers", which is subject to line-by-line approval by delegates from all participating governments.

The *Kyoto Protocol* was adopted in Kyoto, Japan, on 11 December 1997 and entered into force on 16 February 2005. There are currently 192 Parties to the Protocol. The Protocol is based on the principle of Common but Differentiated Responsibilities: it puts the obligation to reduce current emissions on developed countries on the basis that they are historically responsible for the current levels of greenhouse gases in the atmosphere. As a result, it sets - in its first commitment period - binding emission reduction targets for 37 industrialized countries, mostly Member States of the European Economic Area (EU + EFTA). These targets add up to an average five per cent emissions reduction compared to 1990 levels over the five-year period 2008 to 2012. At the

[269] It was replaced in 2013 by the High-level Political Forum on sustainable development which meets both under the General Assembly every four years and the ECOSOC in other years.

[270] The *United Nations Climate Change Conferences* combine the *Conference of the Parties* with the *Meetings of the Parties to the [Kyoto] Protocol, MOP*.

2012 Doha meeting of the parties to the UNFCCCC, the European Union pledged to extend the treaty, binding on the 27 European Member States, up to the year 2020; the reduction target of 20 percent for the EU (after 8 percent in the first commitment period) is pending in the internal ratification procedure. On the other hand, the U.S. - accounting for 36% of emissions in 1990 - signed the protocol in 1992 but it was never submitted to the Senate for ratification. Furthermore, Canada withdrew 2011 from the protocol.

Regarding the *Post-Kyoto-Period*, for a long time little progress was achieved. As the meagre result of the United Nations Climate Change Conference in 2012, it was agreed that the new framework for the Post-Kyoto-Period will be negotiated at the December 2015 meeting of the COP in Paris. The guiding idea was that the Post-Kyoto agreement should extend commitments beyond the Annex I countries and include also emerging economies. However, China, India, and the United States (responsible for 29.5, 6.6 and 14.9 percent of the world's greenhouse gas emission in 2012 respectively, the EU accounting for 9.6) have already signalled that they will not ratify any treaty that will commit them legally to reduce CO_2 emissions. For the COP21, they submitted at least commitments, albeit with qualifying remarks saying e.g. that the country will make a best effort to attain the announced goals. The heterogeneity of the countries' commitments is so pronounced that one has rather to think of a collection of letters of intent than of a formal agreement. The commitments will therefore be subject to a review process every five years. Also, the financing of the US-$ 100bio fund intended to finance adaptation and mitigation measures in less advanced countries is all but clear. Therefore, the decisions taken in Paris in December 2015 are to be seen as an important landmark within a process of negotiations that will go on for years.

2 The Bretton Woods Institutions and akin organisations

The Bretton Woods Institutions owe their name to the conference held in 1944 in the Mount Washington Resort in Bretton Woods, half way between Boston and Montreal, and was attended by representatives of the 44 allies in WWII. As their name expresses, the Bretton Woods Institutions consider, in their own understanding, that they have an origin of their own. Indeed, the conference of San Francisco that led to the creation of the UN took only place a few months later. This explains the absence of detailed discussions on the relationship between the two systems. It is evident, however, that the idea of the Bretton Woods institutions constituting Special Agencies within the UN system remained grey theory.[271] Among others, two reasons can be advanced to explain this fact:

- First, the Soviet Union decided not to become member of the Bretton Woods Institutions, allegedly due to an insufficient allocation of voting rights (quota), but the different economic system – central planning versus a market economy – would definitively have made difficult a membership of the Soviet Union and its allies in the IMF and the World Bank Group.

- Secondly, the quota system sets the Bretton Woods Institutions in contrast to the UN Special Agencies and most other UN bodies. While in the latter the rule 'one country, one vote' prevails, voting rights in the Bretton Woods Institutions are attributed – with some attenuating factors – in accordance with the economic importance of countries.

Among the two Bretton Woods Institutions, we will first look at the IMF, before turning to the World Bank Group since the latter has more overlap than the IMF with the Regional Development Banks that will also be covered within this section. The WTO, a 'related organisation' in UN terminology, was portrayed in Chapter 1.

The IMF

The IMF's primary purpose is to ensure the stability of the international monetary system —the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Fund's mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.

To maintain stability and prevent crises in the international monetary system, the IMF as a first activity reviews country policies and national, regional, and global economic and financial developments through a formal system known as surveillance. The IMF advises its 188 member countries, encouraging policies that foster economic stability, reduce vulnerability to economic and financial crises, and raise living standards. It provides regular assessment of global prospects in its World Economic Outlook, of financial markets in its Global Financial Stability Report, and

[271] Read the IMF homepage: "*Created in 1945, the IMF is governed by and accountable to the 188 countries that make up its near-global membership.*"

of public finance developments in its Fiscal Monitor, and publishes a series of regional economic outlooks.

Secondly, IMF financing provides its members breathing room to correct balance of payments problems: national authorities design adjustment programs in close cooperation with the IMF that are supported by IMF financing; continued financial support is conditional on effective implementation of these programs.

As a third activity, the IMF provides technical assistance and training to help member countries strengthen their capacity to design and implement effective policies. Technical assistance is offered in several areas, including tax policy and administration, expenditure management, monetary and exchange rate policies, banking and financial system supervision and regulation, legislative frameworks, and statistics.

Forth, the IMF issues an international reserve asset known as Special Drawing Rights (SDRs) that can supplement the official reserves of member countries. Total allocations amount to about SDR 204 billion (some US-$ 309bio). IMF members can voluntarily exchange SDRs for currencies among themselves.

The mandate of the IMF is contentious since its beginnings

In preparation of the Bretton Woods Conference, John Maynard Keynes, the world's outstanding economist of the late Thirties and by profession a banker in the City of London, had prepared in 1942 three famous memoranda suggesting the creation of three institutions in the post-war-period that should help prevent a recurrence of the Great Depression: One was the International Clearing Union (which became the IMF), one was the International Investment Fund (which became the International Bank for Reconstruction and Development or the World Bank), and one the International Commodity Buffer Stocks (also called the International Trade Organisation (ITO)). The International Trade Organisation remained still-born; only in 1995, the General Agreement on Tariffs and Trade was replaced by a fully-fledged international organisation, the WTO. The IBRD should in the course of time become one of the five pillars of the World Bank Group (see below). Disputed remained the role of the IMF and these discussions in a certain sense also overshadowed the intense debate about the IMF's role starting in the late 90'. While Keynes favoured the constitution of a central bank, capable of creating money and thus in a position to stimulate also the economy of creditor countries, his opponent, Harry Dexter White, from the US Treasury, favoured a banking approach and proposed a fund, composed of contributions of member countries in gold and their own currencies, with its activities focused on the countries running into current account problems. The latter should obtain credit, allowing domestic adjustment to be extended over the 18 month to five years over which the credits were granted, instead of devaluating their currency or adopting a brisk deflationary policy. Credit would in fact be granted in US-Dollars, the US pegging their currency to 35 Dollars for one ounce of gold.[272]

The IMF was thus conceived as a club among equals, all fully responsible of their monetary policy. Since only industrialised nations were thought to be present when designing the operation of the fund, the member states were considered to have similar capabilities to redress their economies in the case of current account problems (although the US were in a far better situation than the other countries in this regard[273]*). While 25% of the quota a country had to pay in could be withdrawn as a US-Dollar-credit more or less unconditionally, in the event of disequilibria making the injection of larger amounts of foreign currency in money markets necessary to stabilise the exchange rate, larger credits would only be granted conditional on the adoption of an austerity package by the debtor nation, and the implementation of the latter would be supervised by the Fund. We thus have a banking approach, where the bank does not interfere with the decisions of the company's board in normal times (while a central bank is continuously reconsidering how its policy affects markets), but where*

[272] It is worth noting that the IMF's role has in principle fundamentally changed with the end of the Bretton Woods system in 1971/1973, from avoidance of devaluations to guarantee the servicing of the (foreign) debt. Neither of these escape doors was ever firmly closed. A necessary condition for the unimpaired flow of goods and credits is that such decisions remain exceptional events, however.

[273] The US came only under pressure when creditor countries started to exchange $ for gold. This occurred only in the early 70' and this unfriendly act against the US led to the breakdown of the Bretton Woods system. Before, the US had used their capacity to print money in a way that led to record inflation in creditor nations.

control becomes ever tighter the more indebted a company is, the bank (as the typical major debtor) taking over the responsibility when bankruptcy occurs or is immediate (and will typically do this to safe the creditors interests …). In the economic literature, to stipulate strong creditor rights in private bankruptcy law is not considered as unfavourable for economic development. Such legislation creates strong incentives on the debtor side to avoid a bail-out and the prospect of strong reactions by the debtor in the event of adverse evolutions raises in turn the readiness of creditors to lend money. Whether this mechanism extends to nations as debtors and to what extent this is really the case may be disputed, however.

A major critique of the IMF's activities is that current account problems are considered by the fund as having their roots in domestic policies. This is a false critique in the sense that the need to correct a current account imbalance arises independently of the question whether the origin of the imbalance is domestic or foreign. The world economy is not a bible class where countries will refrain from benefitting of an improvement of their terms of trade if this causes problems to importing nations. Perhaps, the latter are economically even better off than the countries benefitting from the improvement of export prospects. The fact is that countries experiencing adverse foreign evolutions may innocently become poorer even if they are poor already at the outset. The credits by the IMF bring them temporary relief, and, in the best case, allow them to continue to grow although it will be clear that the additional GDP will more or less end in the pockets of the countries that have improved their terms of trade. Not to help the indebted countries by 'à fonds perdu' payments is morally not wrong since in the latter case the order of priority in granting development aid would be overthrown. Furthermore, a moral hazard problem would be created: The prospect of unconditional transfer payments would induce debtor countries not to care sufficiently for their current account exposure. It is also all but clear that monetary policy should become expansionary when single countries or groups of countries run into severe current account problems. This is suggested by calling for a symmetry of adjustment efforts but such a reaction may just postpone adjustment while leading into global inflation.

The problems with the IMF's help are of a different nature. First, the prospect that the IMF will step in in the event of current account problems favours irresponsibility by the private lenders in the build-up of the imbalance. In principle, countries not capable of operating a correction should be sent to the Paris Club[274] *in order to negotiate a rescheduling of their debt so that these lenders would incur a loss. The experience with Greece in the initial stage of the country's crisis (fear of a domino effect) has shown the limits of this disciplining mechanism. Secondly, the presupposed capability of debtor nations to correct a current account deficit held true for the leading nations when the IMF was launched. They all had a pre-existing capacity to export. In countries with a deficient capacity to (re-) launch exports, redress will become very costly since the only way to balance the current account is then to compress imports and this can hardly be achieved without compressing domestic demand (i.e. GDP) for a longer period. Therefore, the risk of a protracted depression looms around the corner, raising the (more theoretical) question whether national sovereignty should be disregarded and corrective measures enforced prior to the outbreak of a crisis. Indeed, to create a resilient export sector by trade liberalisation is a valid prescription only in normal times but may produce doubtful results when newly implemented in times of crisis. A third aspect is that the government in place proposes the adjustment measures. These proposals will eventually put the burden of the adjustment on the poor and not on the political clientele of the party in government. It is not clear whether the IMF has the authority and capacity to enforce a bail out with features that protect the poor. Forth, given the lack of resilience of many countries asking for IMF help, the adjustment period may extend far beyond the few quarters that are at best the longest horizon relevant in the minds of members of the banking community, the other interlocutors of the IMF.*[275] *The problem of coordinating the austerity package with longer lasting policies arises. This leads to an enhanced need for consultation and coordination with other international organisations having built up knowledge and experience in the country under consideration. The alternative, namely the idea that implementing market mechanism will automatically bring forth the solution, may at times have been favoured by the IMF but is a default reflection by trained economists that often did not stand the test of*

[274] See box on top of next page

[275] The IMF's interest of taking also to banks is that he may achieve that banks do not proceed to premature rescuing operations for their loans, thereby further destabilising the country.

reality. Fifth, if the imbalance is largely caused by domestic policies, the solution of the problem may be constituted in bringing forth a deeper political change. Such change has to be the result of interior political evolutions. A sharp reduction of GDP will favour political change. However, it would not only be cynical by the creditor nations to bet on such an evolution by allowing for a sharp fall of GDP, but also very risky. There is considerable potential that populist movements will come to power with simple solutions that, when implemented, will not stand the test of reality, and/or with totalitarian attitudes that put high costs in terms of individual freedom on those parts of the population that are not ready to align to such a movement.

The IMF has reacted to these problems and continues to reconsider his policies in the aftermath of the global financial and sovereign debt crisis starting in 2008. In Chapter 16, we will e.g. make reference to the considerations formulated with respect to the control of financial capital flows in countries facing an unwarranted appreciation of their currency.

The primary source of the IMF's financial resources is its members' quotas, which broadly reflect members' relative position in the world economy. In addition, the IMF can borrow temporarily to supplement its quota resources. The amounts single countries can mobilize by calling on their quotas are limited, however, when set into relation to the financing needs these countries may face in the advent of a crisis. This led in the 70' to a first allocation of Special Drawing Rights. These extended world-wide non-gold reserves of central banks by some 8%. Inflation and economic growth brought this ratio down to some 1% before a new allocation of SDRs was decided and became effective on 28 August 2009. The increase by US-$ 250bio was the response to the call by the G-20 Heads of State and the IMF's International Monetary and Financial Committee (IMFC) at their respective meetings in April 2009 to secure that - faced with the global financial crisis of 2008 - the IMF should not give the impression to financial markets that he could run out of funds. This would have undermined the credibility of his actions. By this allocation which was made to IMF members in proportion to their existing quotas in the Fund, the SDRs now cover again the equivalent of 1% of the world trade volume.[276]

The Paris Club

The Paris Club is an informal group of officials from creditor countries whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. Provided debtor countries undertake reforms to stabilize and restore their macroeconomic and financial situation, Paris Club creditors help with an appropriate debt treatment. [277] *Paris Club creditors provide debt treatments to debtor countries in the form of rescheduling, which is debt relief by postponement or, in the case of concessional rescheduling, reduction in debt service obligations during a defined period (flow treatment) or as of a set date (stock treatment). The Paris Club was created gradually from 1956 on, when the first negotiation between Argentina and its public creditors took place in Paris. The Paris Club treats public claims, that is to say, those due by governments of debtor countries and by the private sector, guaranteed by the public sector to Paris Club members. A similar process occurs for public debt held by private creditors in the London Club, which was organized in 1970 on the model of the Paris Club. It is an informal group of commercial banks meeting to renegotiate the debt they hold on sovereign debtors. Creditor countries meet ten times a year in Paris for Tour d'Horizon and negotiating sessions, chaired by the Director of the General*

[276] The amount of 250bio was determined on the basis that emerging economies less China and oil exporters should have overall reserves equivalent to the value of their imports during 5.5 month and/or that these reserves should cover 165% of their short-term debt. See the proposal for a general allocation of SDR, to be retrieved under https://www.imf.org/external/np/tre/sdr/proposal/2009/0709.htm . The opening of such credit lines dispenses the countries from accumulating reserves by current account surpluses. As credit lines, they cannot be directly assimilated to printing money, the latter constituting an inflationary risk. Such risks hinge on the degree and the economic circumstances at the moment of their activation.

[277] Cross default clauses are common in loan and credit contracts, meaning that when one creditor is no longer served by a debtor (e.g. a repayment of a bond does not occur), in principle all loans and credits become due so that a solution involving all creditors needs to be negotiated. This limits moral hazard by the debtor, and to avoid that the first lender in time will possibly be last served is a precondition for lending over longer horizons over which a significant non-anticipated deterioration of a debtor's situation may occur.

Directorate of the Treasury of the French Ministry of Finance and Public Accounts. Since 1983 and until May 2014, the Paris Club has signed more than 430 agreements covering 90 debtor countries over US-$ 583bio.

Source: https://en.wikipedia.org/wiki/Paris_Club as of October 2015

At the top of the IMF's organisational structure is the Board of Governors, which consists of one Governor and one Alternate Governor from each member country. The Board of Governors meets once each year at the IMF-World Bank Annual Meetings. The day-to-day work of the IMF is overseen by its 24-member Executive Board, 24 Directors representing countries or groups of countries which represent the entire membership; this work is supported by the IMF staff (approximately 2,600 persons from 142 countries). A member country may request IMF financial assistance if it has a balance of payments need (actual or potential)—that is, if it cannot find sufficient financing on affordable terms to meet its net international payments (e.g., imports, external debt redemptions) while maintaining adequate reserve buffers going forward. An IMF loan provides a cushion that eases the adjustment policies and reforms that a country must make to correct its balance of payments problem and restore conditions for strong economic growth.

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 70' and the debt crisis of the 80' were both followed by sharp increases in IMF lending. In the 90', the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges of demand for IMF resources. Deep crises in Latin America and Turkey kept demand for IMF resources high in the early 2000s. IMF lending rose again in late 2008 in the wake of the global financial crisis. As of 28 August 2014, the biggest borrowers were Greece, Portugal, Ireland, Ukraine, and Mexico, while Poland, Colombia and Morocco had the biggest precautionary loans outstanding.

Over the years, the IMF has developed various loan instruments that are tailored to address the specific circumstances of its diverse membership. Low-income countries may borrow on concessional terms through the Extended Credit Facility (ECF), the Standby Credit Facility (SCF) and the Rapid Credit Facility (RCF). Concessional loans carry zero interest rates until the end of 2014. Non-concessional loans are provided mainly through Stand-By Arrangements (SBA), the Flexible Credit Line (FCL), the Precautionary and Liquidity Line (PLL), and the Extended Fund Facility (which is useful primarily for medium- and longer-term needs). The IMF can also provide emergency assistance via the Rapid Financing Instrument (RFI) to all its members facing urgent balance of payments needs.

All non-concessional facilities are subject to the IMF's market-related interest rate, known as the "rate of charge," and large loans (above certain limits) carry a surcharge. The maximum amount that a country can borrow from the IMF, known as its access limit, varies depending on the type of loan. It is typically a multiple of the country's IMF quota. This limit may be exceeded in exceptional circumstances. The Stand-By Arrangement, the Flexible Credit Line and the Extended Fund Facility have no pre-set cap on access. SBAs may be provided on a precautionary basis where countries choose not to draw upon approved amounts but retain the option to do so if conditions deteriorate.

The existence of precautionary loans reflects the fact that the function of the IMF cannot be reduced to the credit that is eventually granted to a country. The signalling effect of IMF decisions to the financial community is at least of the same importance. The readiness of the IMF to grant credit without requiring a renegotiating of the debt between the country in case and its creditors may be a first sign to the banking sector not to withdraw immediately the financial capital they have invested in the country. In later stages, the assessment by the IMF that a country conforms to the commitments made in the adjustment program and remains on track to re-establish its capacity to serve its debt serves the same purpose of reassuring private creditors.

The World Bank Group

The International Bank for Reconstruction and Development is the original institution within the World Bank Group. As the term "Reconstruction" indicates, the IBRD was targeted on allowing the nations hit by WWII to rebuild their economy, also by getting credit in US-$ to buy essential imports from the US. With strong growth in Europe and Japan in the 60' and the former colonies gaining independence, the focus of the World Bank shifted from reconstruction to development. A branch addressing the needs of the poorest countries was added in 1960 by creating the International Development Association (IDA). A third pillar is constituted by the International Finance Corporation (IFC). Furthermore, there are the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID) as the fourth and fifth pillar.

The International Bank for Reconstruction and Development (IBRD) aims to reduce poverty in middle-income countries and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and by analytical and advisory services. Supported projects range from water supply in Costa Rica to revenue administration in Bulgaria, training teachers and providing textbooks in indigenous languages in Guatemala, and strengthening telecommunications regulation in Pakistan.[278] The IBRD raises most of its funds on the world's financial markets and has become one of the most established borrowers since issuing its first bond in 1947. Commitments of the IBRD in fiscal 2014 amounted to US-$ 18.6bio, of which 2% went to Africa, 22% to East Asia and the Pacific, 25% to Europe and Central Asia, 25% to Latin America and the Caribbean, 14% to the Middle East and North Africa and 12% to South Asia. The low share of Africa is explained by the concentration of least developed countries on this continent, the latter qualifying for IDA help (46% of IDA commitments went to Africa and 38% to South Asia).[279]

The International Development Association (IDA) complements, as we have indicated, the World Bank's original lending arm, the IBRD, by lending money on concessional terms, focusing on the world's 77 poorest countries, 39 of which are in Africa. IDA charges little or no interest and repayments are stretched over 25 to 38 years, including a 5- to 10-year grace period. IBRD and IDA share the same staff and headquarters and evaluate projects with the same rigorous standards. In fiscal year 2014, new IDA commitments rose to a record US-$ 22.2bio. In recent years, IDA provided also significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Opposite to the IBRD, the IDA is publicly financed. In order to be able to extend its lending on concessional terms, IDA's purse needs to be periodically replenished by public funds, provided mainly by the richer nations.

The IFC was constituted back in the 50' due to a US initiative launched in the conviction that a good private industry serves developing countries best. The IFC finances private enterprises in developing countries without taking government guarantees, always working alongside other private investors and never managing its investees. Initially endowed with US-$ 100mio in authorized capital, its first investment was a US-$ 2mio loan to help the Siemens affiliate in Brazil manufacture electrical equipment. In 1961, the restriction to lending fell and the IFC was authorized to make equity investments, a major source of today's IFC's profits. The first stake was in Spanish auto parts manufacturer FEMSA. In 1965, the IFC achieved the first syndicated loan, mobilising US-$ 600,000 from Deutsche Bank and others for Brazilian pulp and paper company Champion Cellulose. In 1971, the IFC created a Capital Markets Department to strengthen local banks, stock markets, and other intermediaries. Recognising that global knowledge on industries is one of its most important assets, IFC organised in 1992 in industry departments. One is globall responsible for activities in Infrastructure, one in Agribusiness, one in Oil/Gas/Mining, and one in Chemicals/Petrochemicals/Fertilizers. They complement the one for Capital Markets. In recent years, the focus shifted on the world's poorest countries and other frontier regions left out of the emerging market investment boom. Soon, more than half of IFC investment projects will be in IDA countries.[280]

The Multilateral Investment Guarantee Agency MIGA constitutes the newest member of the World Bank Group. It was created 1988 when the World Bank's Board of Governors decided on a new investment insurance affiliate by endorsing the MIGA convention. The agency operates as a legally separate and financially independent entity, open to all IBRD members. MIGA intends to attract investors and private insurers into difficult operating environments, namely the world's poorest countries, conflict-affected environments, complex deals in infrastructure and extractive industries, especially those involving project finance and environmental and social considerations, additionally also middle income countries where MIGA can have a peculiar impact. MIGA's guarantees protect investments against-non-commercial risks and can help investors obtain access to funding sources with improved financial terms and conditions. Since 1988, MIGA has issued more than US-$ 28bio in political risk insurance for projects in a wide variety of sectors, covering all regions of the world. The agency mobilises substantial additional capacity for clients and governments by partnering with public and private insurance providers. In 2013, MIGA's gross exposure was US-$ 12.4bio.

The International Centre for the Settlement of Investment Disputes ICSID was established as an autonomous international institution by the

[278] Examples according to the brochure "IBRD: Working with People to achieve development results".

[279] World Bank Annual Report 2014, Table 5.

[280] The information is taken from the IFC internet site on its history. See http://www.ifc.org/wps/wcm/connect/CORP_EXT_Content/IFC_External_Corporate_Site/About+IFC/IFC+History

Washington Convention, a multilateral treaty formulated by the Executive Directors of the IBRD, and opened for signature in 1965. The ICSID serves as an impartial international forum providing facilities for the resolution of legal disputes between eligible parties, through conciliation or arbitration procedures. Recourse to the ICSID facilities is always subject to the parties' consent. Evidence for the important role the ICSID plays in the field of international investment and economic development is provided by the considerable caseload and the numerous references to its arbitration facilities in investment treaties and laws. A detailed discussion of foreign investor protection can be found in Chapter 3 of this text.

The balance sheets of the World Bank Group look as follows (figures in US-$ for 2014): The IBRD had investments of 45bio and loans of 212bio of which 58bio were not yet disbursed; on world financial markets, the IBRD had borrowed 158bio. New commitments in 2014 amounted to 23bio compared to 19bio by the IDA. The government financed IDA had 28bio investments and had 127bio disbursed in loans. The IFC held 40bio in liquid assets and had 38bio tied in investments, and borrowed 51bio on world financial markets. The MIGA issued in 2014 new guarantees for 3bio and had a gross guarantee exposure of 12bio and a net exposure of 7bio; the institution generated insurance premia of 79mio. Finally, the work load of the ICSID increased from 63 cases in 2003 to 209 disputes in 2014.

Regional Development Banks

The regional development banks consist of several regional institutions that have functions similar to the World Bank group's activities, but with particular focus on a specific world region. Shareholders usually consist of the regional countries plus the major donor nations. The best-known of these regional banks cover regions which roughly correspond to the United Nations regional groupings of countries, and include the Asian Development Bank, the African Development Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development, on which we focus below.[281]

The African Development Bank was founded in 1964 and has 53 African and 25 non-African countries as its members. It has an authorized capital of UA 67bio (1UA=1.54$) of which UA 21bio were subscribed. Affiliated to the ADB are the African Development Fund (ADF) and the Nigeria Trust Fund (NTF). The number of approved operations amounted in 2013 to 317 operations totalling UA 4.4bio, financed as follows: ADB: UA 1.8bio, ADF: UA 2.3bio and NTF: UA 31.2mio. Loans amounted to UA 2.86 billion (93 operations), grants to UA 697.0 million and equity participations to UA 99.5 million (10 operations). Additionally, guarantees of UA 431.7 million (6 operations) were handed out, and out of special funds 91 operations could be financed by UA 253.4 million. Infrastructure absorbed 57.6 percent of total loans and grants, social projects 9.4 percent, multisector projects 12.6 percent, finance:8.1 percent, agriculture and rural development:12.0 percent, urban development 0.01 percent and the environment 0.3 percent. Total cumulative loan and grant approvals 1967–2013 amounted to 4,003 loans and grants totalling UA 67.22 billion.

The Asian Development Bank was founded in 1966 and has 67 members out of which 19 are non-regional members. Headquartered in Manila, Philippines, the ADB has 29 resident missions and 3 representative offices in Tokyo, Frankfurt, and Washington, DC. New operations in 2013 amounted to US-$ 21bio, US-$ 10bio in the form of loans, including US-$ 1,4bio to non-sovereign borrowers. In the balance sheet, investments of US-$ 23bio and loans of US-$ 53bio were registered, financed by borrowed US-$ 62bio and total equity of US-$ 17bio.

The Inter-American Development Bank (IDB), established in 1959, extends besides loans also grants, technical assistance and does research. IDB's shareholders are 48 member countries, including 26 Latin American and Caribbean borrowing members, who have a majority ownership of the IDB. The Fund for Special Operations (FSO) provides concessional financing to the most vulnerable member countries. Outstanding loans totalled US-$ 70bio in 2013. As of 31 December 2013, 92% of loans outstanding were sovereign guaranteed. Loans and guarantees approved amounted in 2013 to US-$ 13bio.

The European Bank for Reconstruction and Development (EBRD) was established in 1991 to

[281] Other Banks that might be mentioned are the European Investment Bank (EIB) to the extent that the EIB not only serves EU member countries, the Development Bank of Latin America (CAF), the Islamic Development Bank (IsDB) and, on a sub-regional level, the Caribbean Development Bank (CDB), the Central American Bank for Economic Integration (CABEI), the East African Development Bank (EADB), the West African Development Bank (BOAD), the Black Sea Trade and Development Bank (BSTDB), the Eurasian Development Bank (EDB), finally the OPEC Fund for International Development (OPEC Fund).

become the largest financial investor in her region of operations which stretches over more than 30 countries from Central Europe to Central Asia and the southern and eastern Mediterranean region. Owned by 64 countries, the EU and the EIB, bestowed with a capital base of € 30bio, the EBRD is a project finance institution to promote market economies. The cumulative investments 1991-2011 amount to € 71.1bio in 3,374 projects. The EBRD's mandate to achieve transition and reform by working with the private sector was reflected in 2013 in the private sector share of annual Bank investment of 79%. The volume of equity investments was € 1.2bio in 2013 and the equity share was 14%.

3 Multilateral aid granted to Kenya – an example

To make the activities of the portrayed institutions intelligible, we list in this section the projects undertaken in Kenya by the World Bank and the African Development Bank. The IMF does not support countries on a project basis but supports countries for limited time periods based on the adoption of reform programmes by the country. When the country is in a situation to call in IMF support, this leads to a certain overlap since the government share in the projects undertaken by the country with development banks need to find a financing in spite of the austerity programs submitted to the IMF. The former should normally be of high priority, however, so that coordination between development banks and the IMF is more needed on the conceptual than on the project level. IMF support to Kenya is portrayed in part I of Chapter 13 in the underlying publication.

The World Bank

In the period since the beginning of 2007, more than 50 projects had been financed. The 28 projects with a committed amount above US-$ 50mio are (in inverted historic order):

World Bank Projects in Kenya 2007-2015

(> US-$ 50mio)

May 2015	Primary Education Project	88
March 2015	Electricity Modernisation Projects	450
December 2014	Coastal Region Water Supply	200
July 2014	Petroleum Technical Assistance	50
March 2014	Transport Sector Support	203
July 2013	National Safety Net	250
June 2013	Kenya Climate Resilience	155
November 2012	Judicial Performance Improvement	120
August 2012	Urban Transport Improvement	300
May 2012	Nairobi Metropolitan Services	300
May 2012	Water and Sanitation Improvement	300
February 2012	Private Power Generation Support	166
December 2011	Additional Health Sector Support	57
April 2011	Transport Sector Support	300
March 2011	Settlements Improvement	100
December 2010	War against Aids and HIV	55
June 2010	Health Sector Support	100
May 2010	Electricity Expansion	330
May 2010	Youth Empowerment Project	62
May 2010	Municipal Program	100
June 2009	Agricultural Productivity/Agribusiness	82
April 2009	Northern Corridor Financing	253
April 2009	Energy Sector Recovery	80
March 2009	Cash Transfer for Orphans	50
December 2007	Water and Sanitation Service	150
June 2007	War against HIV and Aids	80
March 2007	Natural Resource Management	69
March 2007	Western Kenya Flood Mitigation	86

The African Development Bank

The African Development Bank has approved over 4,501 projects amounting to US-$ 118.7bio from 1967, when it commenced operations, to the end of 2013. Looking at the time span since 2006, 26 of these projects were located in Kenya. They fall in five areas:

Transportation: Nairobi-Thika road (ongoing), Timboroa road (ongoing), Nairobi airport (two emergeny projects after a fire, one ongoing, one approved), outer ring project (approved), Mombasa road (lending phase);

Energy&Power: Mombasa-Nairobi transmission line (ongoing), grid improvement (ongoing), Meneghai geothermal project (ongoing), Lake Turkana windpower (approved, Dutch sponsored project in pipeline), Turkana transmission line (approved);

Water Supply&Sanitation: Support to Water Services Board (ongoing), integrated land and water management project (ongoing), small towns' water supply and waste project (ongoing), Nairobi river systems (ongoing), rainwater management (ongoing), Thwake water supply and sanitation (approved), Branded Toilet Entrepreneurship (approved);

Agriculture&Agro-Industries: Kimira-Oluch Smallholder irrigation (ongoing), smallscale horticulture (ongoing), livestock desease infrastructure (lending phase);

Human Capital: TIVET-project (training, industrial, vocational, entrepreneurship) (ongoing), community empowerment and institutional support (ongoing), quality of higher education in science and technology (ongoing), TIVET phase II (pipeline).

There is a considerable focus on transportation, also to support access to the Great Lakes region. The enhancements at the Port of Mombasa were combined with keeping it operating 24h on all days the weak; this project was linked with investing in the improvement of the northern corridor road network; finally, in 2014, the construction of the Standard Gauge Railway to link Mombasa to Kampala (Uganda) was launched, supported by a US-$ 5bio loan from China.

Chapter 16
The Institutional Framework shaping the Global Financial System

1 A digression on the functions of financial flows

To most international transactions, a financial transaction is the counterpart. Whether goods and services are exported or imported, titles establishing ownership over a foreign direct investment change hands or workers go abroad to earn their family's income, a financial transfer in the opposite direction is linked to such activity. Barter trade is the only exception and usually a very inferior form of trade. There is thus a substantial interest in not only liberalising the primary transaction, but also the secondary transaction – the payment - that goes along with it.

This interest is reflected in the international institutional framework. Also from a historical perspective, to liberalise trade flows was primordial. In the aftermath of WWII, so-called clearing arrangements remained in effect for many areas in many countries. The GATT had therefore as a primary objective to free the exchange of goods from the requirement that the purchaser was allocated a slice of the gross foreign exchange earnings of the country where he was resident. Article XI paragraph 1 of GATT 1947 accordingly foresees: "No prohibitions or restrictions other than duties, taxes or other charges … shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party", but this provision is immediately followed by Article XII, saying: "Notwithstanding the provisions of paragraph 1 of Article XI, any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported, subject to the provisions of the following paragraphs of this Article" [which then fill two pages of text!].

We therefore have to make a distinction: While there is a prohibition to frustrate the payment on the level of the single transaction with the intention to bias trade, such frustration has to be accepted by the foreign exporter or the domestic importer when macro-economic imbalances justify a rationing of the means available for payments to foreigners. Evidently, from the point of view of the single company, it is not at all convincing when payment appears as guaranteed and all of a sudden, the authorities of the importing country are entitled to prohibit the importer to settle the transaction. The persons in charge of designing the post WWII economic system were well aware of this incongruence. In fact, the International Trade Organisation (ITO), the stillborn precursor of GATT 1947, was not conceived in isolation. The ITO was but the third pillar of a system that comprised also two other pillars, those that make up today what is called the Bretton Woods Institutions. The IBRD should allow for a financing of long term trade imbalances linked to an anticipated excess demand of post war Europe in, most notably, investment goods that would be covered by imports from the US. The IMF should allow for corrective actions in the event of trade imbalances appearing on short notice, with the guiding principle that the trading partners do not suffer a bad surprise due to currency devaluations.

The functioning of the Bretton Woods Institutions was already described in some detail in Chapter 15. The focus there was on the support these organisations can provide to a single country, as for instance Kenya. In this chapter, we will present the Bretton Woods Institutions for a second time: Not as instruments of development but as organisations responsible for preventing global imbalances in the financial sphere. This shift goes along with the relegation of the IBRD (or the World Bank Group in general) as the institution acting alongside the IMF on a second rank. The place of the IBRD as the international organisation acting alongside the IMF will now be occupied by the BIS, the Bank for International Settlements. The presentation will be extended to other fora where global financial imbalances are discussed and to organisations supervising international financial transactions in order to prevent crime and terrorism.

This change in focus is tantamount to a shift of attention from transactions in the extracting and transforming industries to transactions in the financial sector. Portfolio capital and lending by banks are henceforward of primary interest. The volume of these transactions has tremendously increased over the past years. Indeed, an underlying operation such as the export of an investment good can give rise to financial transaction of a total amount that is on a gross basis easily four or five times as important as the value of the machine that is shipped: The financing of the machine can e.g. come from a third country; and if the exchange risk is dynamically hedged, to adjust the gamma of the call or put requires daily operations in the exchange market.[282]

It is also doubtful whether it is always appropriate to consider the export of a machine as the underlying transaction. That machines are exported may in the end be the result of decisions by owners of financial wealth or banks operating on an international scale which desire to change the currency or the country in which their assets are denominated and/or located.

To better understand the latter point, the notion of a stock-flow equilibrium proves helpful. The trade balance is about equilibrating flows in a given moment of time. But, remembering the original task of the IBRD, to equilibrate imports and exports in any moment of time is economically not optimal. As in the private sphere, also at the country level, to borrow today and to repay tomorrow when the fruits of the investment financed from abroad can be collected is profitable to all parties. Although the volume of global financial flows has progressed enormously over the last one or two decades, the potential for such cross border financial placements is certainly not exhausted.[283]

The salient point now is that already minor changes in the perception of foreign investment opportunities can cause a considerable reshuffling of portfolios and bank loans. A quantity reaction to these changing appreciations is not possible. Entire hotels cannot be shipped in a fortnight from destination A to destination B when terrorist attacks make country A insecure and less demanded by tourists. The adjustment occurs by way of an adjustment of the valuation of the assets in the different countries. A quantity reaction will normally also occur, but only with a delay and often limited in volume.[284] It is for this reason that, as argued above, the export of a machine can be the result of capital reshuffling.

Accordingly, the term “misaligned exchange rate” has to be used with great caution. It is usually used by the machine manufacturer, not the portfolio investor. The reason is that exchange rates may primarily react in order to establish an equilibrium of stocks. Exchange rates are a price and may as such immediately move upwards or downwards to stem shifts in the appreciation of a country by investors, be they foreign or domestic. To continue with our example, at a depressed exchange rate, the owner of the hotel in A will no longer be interested in obtaining possession of a hotel in B, or, if he still is, he has now a better chance to find someone interested in acquiring his hotel in A. The case of a terrorist attack is just one possible trigger for exchange rate movements, however, used here for expository purposes since it explains an instantaneous reaction of asset markets. It is more common that pressures on exchange rates build up gradually. Usually, badly conceived and implemented macroeconomic policies and not terrorist attacks destabilise a country’s economy. Financial markets will not qualify macro-economic policies as unsustainable from one moment to the next (although a change in the government in power may have this effect). Rather, while one economic actor will leave the country, other investors may step in if offered a slightly higher interest rate. Furthermore, there is no guarantee at all that the qualification of the macro-economic stance prevailing in an economy is justified on objective grounds. The phenomenon of herding is widespread on financial markets, leading to contagion, and there may also be an economic rational in not only considering the objective factors underlying a country’s economic situation but also how the perception of the underlying factors by the other actors on the financial markets changes (see appendix on speculation in the underlying publication).

Clearly, currencies that serve to denominate a vast offer of assets serving as a store of value will be more affected by the kind of portfolio reshuffling just described than the currencies which essentially only serve to settle the daily import and export transactions of a country. When we consider the IMF and related fora in their role as

[282] See the appendix for an explanation of these transactions.

[283] Support for this view is provided by the so-called Feldstein-Horioka puzzle. Feldstein and Horioka (1980) argued that if there is perfect capital mobility, we should observe low correlation between domestic investment and saving but, empirically, Feldstein and Horioka observed that domestic savings rates and domestic investment rates are highly correlated. This phenomenon has not really disappeared, since. See: Feldstein, Martin and Charles Horioka (1980): Domestic Saving and International Capital Flows, Economic Journal 90 (358): 314–329

[284] New hotels will tend to be only constructed in B.

institutions responsible for global financial stability, other countries and their currencies are in the forefront than in the lending business. BIS membership (see below) maybe indicative in this regard. Still, emerging economies remain on the scene, and this for two reasons: i) emerging economies have issued foreign denominated bonds in a volume relevant for the good functioning of world financial markets; if trouble in one emerging economy changes the appreciation of a whole group of emerging economies and pushes the interest rate these have to pay on their borrowing upwards (the phenomenon of "contagion") then global financial stability can also be at risk; ii) if trust in the established vehicles for making financial placements is undermined (the situation prevailing in the financial and sovereign debt crises that emerged in 2008), then the (transaction) currencies of the emerging economies may at least temporarily enter into consideration as an alternative store of value, a role that commodities may also perform in such times (see again the annex on speculation in the underlying publication).

2 The institutions where global financial stability is debated

The IMF and global financial stability[285]

When the IMF was founded, it was not at all evident that the organisation will later primarily be known for the adjustment programs in favour of developing countries the fund conceives and monitors. Its major function was thought to be to prevent a series of competing devaluations between the major currencies as occurred in the 30'. To this end, the currencies of the industrialised world were pegged to the dollar and the latter to the value of gold. Major actions of the IMF after the European currencies had become convertible towards the end of the 50' were to defend the parity of the frail British pound. Since it was not clear whether the financing through the member states quota would be sufficient in the event of an attack, a backup strategy was devised, the General Arrangements to Borrow (GAB). Participants in the GAB were Belgium, Canada, France, Germany, Italy, Netherlands, Sweden, the UK, the US, from 1964 also Switzerland and finally, based on a special arrangement, Saudi-Arabia. These countries became known as the G-10 and decided ten times on the activation of the GAB, the United States having been the last country to call on the GAB when the Fund borrowed from Japan and Germany to finance a U.S. reserve tranche purchase of SDR 777 million (then about US-$ 1.0 bio) in 1978. The United Kingdom drew on the GAB five times between 1964 and 1977, for a total drawing of SDR 3'246 million. France drew on the GAB in 1968 and in 1969, for a total drawing of SDR 640 million, Italy drew SDR 90 million in 1977.[286] Thus, activations occurred also after the end of the gold standard. In fact, it was the G-10 that agreed to the Smithsonian Agreement in December 1971 by which the gold parity of the $ was changed for a first time since the creation of the Bretton Woods System after WWII when the US promised to exchange $ for gold at a fixed rate. This commitment had unilaterally been lifted by the US in August 1971 under the pressure of financing the Vietnam War and the Great Society and increased competitiveness of the other industrialised nations. Since inflationary monetary policy by the FED system continued, the world had soon to acknowledge that the anchor had definitely lost ground so that, in 1973, the major G-10 members decided to let their currencies float freely against the US currency.

The latter decision did not mean the end of the organisation, but a shift in its activity. With regard to the major industrialised nations, coercive measures such as a parity grid ceased to exist and gave way to general discussions between central bankers and finance ministers about the pursuit of macro-economic policies on a global scale. Within this concern for worldwide financial stability, major common actions were decided on the occasion of the series of crises that hit global financial markets in particular in the 90'. Concern whether the IMF would be able to mobilise enough lending also in the advent of major crises led to the extension of the GAB to the NAB, the New Arrangement to Borrowing, by which 38 countries declare their readiness to lend to the Fund. The trigger was the Mexican financial crisis in the mid-90' which led the G-20 countries to propose the creation of the NAB in 1997. In 2009, the volume which can be borrowed under the NAB was significantly increased. In parallel, the G-10 lost in public visibility. In the Greek crisis, the director of the IMF assumed the prominent role, backed by the Board of Governors of the IMF.

[285] General information on the IMF and its history is provided by Schlemmer-Schulte, Sabine (2014): International Monetary Fund IMF, Oxford Public International Law, http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e492

[286] http://congressionalresearch.com/97-467/document.php?study=The+IMFs+%26quot%3BGeneral+Arrangements+to+Borrow%26quot%3B+GAB+A+Background+Paper

Parallel to such big rescue operations, smaller countries were regularly supported by the IMF under the condition that they adopt an austerity program (see Chapter 15). This focus on countries outside the industrialised world led to the claim that there should be more symmetry in the Fund's activities. For this reason, Article IV consultations are now also held with surplus countries, resulting in noncommittal recommendations on their behalf.

More importantly, the IMF has to fight a tendency to be the public institution that heals irresponsible prior lending of banks to weak countries when their pitcher is broken so that they can no longer go to the well of private credit. The bail-out of countries is simultaneously also the bail-out of their lenders and the latter element risks to dominate. In the 2008 financial crisis, the exposure and fragility of major global banks left public authorities without choice regarding whether they should or should not step in with the tax-payers money and extend loans to the wobbly countries at the periphery of the EU. The banking sector fought the following assessment with a battery of PR activities and extended lobbying, but the provisioning with own capital of loans to sovereign debtors according to the Basle II rules had proven to be insufficient. The standards set within the BIS and in affiliated bodies in this regard - to which we turn now - became a major concern of the IMF and its member states. This shows up in the clear focus on financial sector stability the documents of the Article IV consultations with members states know since 2008.

The Bank for International Settlements[287]

Established on 17 May 1930, the Bank for International Settlements (BIS) is the world's oldest international financial organisation. The BIS has 60 member central banks, representing countries from around the world that together make up about 95% of world GDP. The head office is in Basel, Switzerland, and there are two representative offices: in the Hong Kong Special Administrative Region of the People's Republic of China and in Mexico City. The mission of the BIS is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks. In broad outline, the BIS pursues its mission by: fostering discussion and facilitating collaboration among central banks; supporting dialogue with other authorities that are responsible for promoting financial stability; carrying out research and policy analysis on issues of relevance for monetary and financial stability; acting as a prime counterparty for central banks in their financial transactions; and serving as an agent or trustee in connection with international financial operations.

Monetary and financial stability is a precondition for sustained economic growth and prosperity. Reflecting the public good character of this goal, the BIS also makes part of its work available free of charge to the wider public, including: its own analyses of monetary and financial stability issues; international banking and financial statistics that underpin policymaking, academic research and public debate. With regard to its banking activities, the customers of the BIS are central banks and international organisations. As a bank, the BIS does not accept deposits from, or provide financial services to private individuals or corporate entities.

The Bodies where Supervisory Authorities coordinate their activity

The Basel Committee on Banking Supervision[288] is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. G-10 members founded the Basel Committee in 1974 in reaction to the bankruptcy of the German Herstatt-Bank. Today, the meetings are attended by representatives of Central Banks and Bank Supervisory Authorities of some 30 countries. The Committee's Secretariat is located at the Bank for International Settlements in Basel, Switzerland, and is staffed mainly by professional supervisors on temporary secondment from member institutions. In addition to undertaking the secretarial work for the Committee and its many expert sub-committees, it stands ready to give advice to supervisory authorities in all countries. Of particular importance is currently the implementation of the Basel III standards. They address the quality of the own capital, the provisioning of loans with an adequate share of own capital, the imposition of an overall leverage ratio, and the integration of off-balance sheet activities, the business with derivatives and the bank's own risk models into the supervisory framework. Keywords are anticyclical buffers – e.g. the right of a bank to convert loans granted to her into own capital in the advent of serious losses - , macro prudential supervision – i.e. to look in a coherent way simultaneously at the financial stability of banks and risks at the macro-economic level such as a housing boom - and stress tests – by the latter, situations of contagion in the banking

[287] https://www.bis.org/about/index.htm?l=2&m=1%7C1

[288] http://www.bis.org/bcbs/about.htm?m=3%7C14%7C573

system are simulated in order to identify the weak ones among the banking institutes.

The International Organization of Securities Commissions (IOSCO)[289] is the international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector. IOSCO develops, implements and promotes adherence to internationally recognized standards for securities regulation. It works intensively with the G20 and the Financial Stability Board (FSB) on the global regulatory reform agenda. IOSCO was established in 1983. Its membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions; securities regulators in emerging markets account for 75% of its ordinary membership. The secretariat is located in Madrid. The IOSCO Objectives and Principles of Securities Regulation form the basis for the evaluation of the securities sector for the Financial Sector Assessment Programs (FSAPs) of the International Monetary Fund (IMF) and the World Bank

The International Association of Insurance Supervisors IAIS, established in 1994, represents insurance regulators and supervisors of more than 200 jurisdictions in nearly 140 countries, accounting for 97% of the world's insurance premiums. Its objectives are to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability. In October 2011, IASO has adopted a set of 26 Insurance Core Principles.[290] The secretariat is located at the BIS in Basel.

The Financial Stability Board[291]

The Financial Stability Board FSB promotes global financial stability by coordinating the development of regulatory, supervisory and other financial sector policies and conducts outreach to non-member countries. The FSB has a unique composition among international bodies, because it brings together senior policy makers from ministries of finance, central banks, and supervisory and regulatory authorities, for the G20 countries, plus four other key financial centres – Hong Kong, Singapore, Spain and Switzerland. In addition, it includes international bodies, including standard-setters and regional bodies like the European Central Bank and European Commission. This means it has all the main players who set financial stability policies across different sectors of the financial system sit at one table, securing a high degree of implementation although decisions of the FSB cannot replace the normal national and regional regulatory process. The FSB has a close relationship with the G20. It was transformed from the earlier Financial Stability Forum (FSF) at the initiative of the G20, and the G20 regularly endorses the FSB's policy agenda although the FSB shall come to independent policy views on pending issues.

Additional international fora debating global economic policy coordination

The G-10, G-20, G-33 and G-90 within the WTO (see Chapter 1) are not to be confounded with the G-7, G-8, G-10, G-20, G-30 and G-77 which have a heterogeneous origin .While they operate formally independent of a specific international organisation, several of these international organisations are keen to provide input to these fora. Their high relevance for the definition of global economic policies and global concerns in general is rooted in their membership.

The Group of 7 (G7) is a group consisting of the finance ministers and central bank governors of seven major advanced economies, namely Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The European Union is also represented within the G7 and the IMF's Managing Director usually participates. They meet to discuss primarily economic issues. According to the Credit Suisse Global Wealth Report of October 2014, the G7 countries concentrate 64% of the net global wealth (US-$ 263 trillion) within their borders.

The Group of Eight (G8) was founded in 1975 as G-6 in the turbulent times in the aftermath of the breakdown of the Bretton Woods System and the first oil price shock at Rambouillet Castle near Paris. Issued out of a gathering of finance ministers and central bank representatives, it was conceived as a meeting of head of states to discuss global economic policies but soon addressed global concerns in general. Canada joined to balance the strong representation of Europe (with Germany, France, Italy and the UK), Japan and the US constituting the other members of the G7 for many years. Russia, which was invited to join as the last member, was excluded from the forum

[289] https://www.iosco.org/about/?subsection=about_iosco

[290] http://iaisweb.org/index.cfm?event=showPage&nodeId=25227

[291] Text from http://www.financialstabilityboard.org/what-we-do/

by the other members on 24 March 2014 as a result of its involvement in the 2014 Crimea crisis in the Ukraine. While membership overlaps again with the G7 countries, given the attendance of head of states, the focus of the former G-8 is more on global political issues in general than on economics.

The Group of Ten or G-10 refers to the group of countries that have agreed to participate in the General Arrangements to Borrow (GAB, see above). In recent years, power has shifted from the G-10 to the G-20 as the move from the GAB to the NAB documents, the G-20 having called for the constitution of the NAB. Different from the G-20, emerging economies which constitute today an important part of the world economy are not part of the G-10.

The Group of Twenty (also known as the G-20 or G20) is a forum for the governments and central bank governors from 20 major economies. The members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russian Federation, Saudi Arabia, South Africa, Turkey, United Kingdom, United States—and the European Union (EU). The EU is represented by the European Commission and by the ECB. Collectively, the G-20 economies account for around 85% of the gross world product (GWP), 80% of world trade (or if excluding EU intra-trade: 75%), and two-thirds of the world population. The G-20 was proposed by former Canadian Prime Minister Paul Martin as a forum for cooperation and consultation on matters pertaining to the international financial system. The group was formally inaugurated in September 1999, and held its first meeting of finance ministers in December 1999. It seeks to address issues pertaining to the promotion of international financial stability that go beyond the responsibilities of any single international organization. After an initial summit meeting in 2008, the ambition is that the G-20 nations meet annually also at the level of heads of state, so on 15 November 2015 in Antalya (Turkey). As the 2015 G20 president, Turkey aims to develop policies to better integrate disadvantaged groups such as women and youth into the economy, to reduce inequality and to promote integration of SMEs and LIDCs (low-income developing countries) into the global economy. Beyond the further implementation of the financial regulation framework and investment, the summit discussed a wide range of other “deliverables”, ranging from Action Plans on Anti-Corruption and Energy Efficiency to a 25% by 2025 female employment participation target.

The Group of 77 at the United Nations is a loose coalition of developing nations, designed to promote its members' collective economic interests and create an enhanced joint negotiating capacity in the United Nations. There were 77 founding members of the organization, but by November 2013 the organization had expanded to 133 member countries. Bolivia held the Chairmanship for 2014. The group was founded on 15 June 1964 by the "Joint Declaration of the Seventy-Seven Countries" issued at the United Nations Conference on Trade and Development (UNCTAD). The first major meeting was in Algiers in 1967, where the Charter of Algiers was adopted and the basis for permanent institutional structures was laid. There are Chapters of the Group of 77 in Rome (FAO), Vienna (UNIDO), Paris (UNESCO), Nairobi (UNEP) and the Group of 24 in Washington, D.C. (International Monetary Fund and World Bank).

Finally, the Group of Thirty is a private body, constituted of eminent persons out of business and academia. They see their mission in deepening the understanding of global economic and financial issues. The effects of political decisions shall be assessed and options for policy with respect to important global challenges shall be evaluated. The members meet twice a year to proceed to an assessment of economic, financial and political evolutions. The G-30 is financed by foundations, banks, companies, central banks, funds and private persons. The G-30 has its seat in Washington D.C.

The OECD

The OECD was founded in 1961 to stimulate economic progress and world trade. [292] The OECD originated in 1948 as the Organisation for European Economic Co-operation (OEEC) to help administer the Marshall Plan (which was rejected by the Soviet Union and its satellite states). The OECD remains up until today a forum of countries committed to democracy and the market economy. Most OECD members are high-income economies with a very high Human Development Index (HDI) so that the OECD was often considered the club of the rich industrialised nations. The OECD provides a forum in which the governments of the member states work together to seek solutions to common problems, share experiences and identify best practices to promote

[292] Paragraph mainly taken from the mission statement on the OECD homepage: http://www.oecd.org/about/

better policies for better lives. For more than 50 years, the OECD has helped forge global standards, international conventions, agreements and recommendations in areas such as governance and the fight against bribery and corruption, corporate responsibility, development, international investment, taxes, and the environment, to mention a few. Co-operation, dialogue, consensus and peer review drive the OECD as it seeks to fulfil its vision of a stronger, cleaner, fairer world economy and society. The OECD is also one of the world's largest and most trusted sources of comparable statistical data on economics, trade, employment, education, health, social issues, migration, the environment and many other fields. It carries out its mission thanks to more than 200 committees and working groups of national experts and decision makers, and a high-quality permanent Secretariat. The OECD includes 34 member countries and is in accession talks with Colombia, Latvia and the Russian Federation. Brazil, the People's Republic of China, India, Indonesia and South Africa are OECD Key Partners. Several fora and some of its instruments are open to participants of other countries. Additionally, the OECD hosts the secretariat of several international programmes. Below we refer to the FATF and the IEA.

Currently, the OECD has some difficulties in defining its role among other global institutions. In earlier decades, the OECD was strong in conceptualising next steps in liberalising trade that then were put down in formal commitments within the GATT. The sticky process of the Doha negotiating round within the WTO has shown the decisive role countries that are not members of the OECD play today in defining trade rules. There is also a trade-off between the number of members, each sitting directly at the discussion table, and the incorporation of all members of the G20. Some of the latter may also prove difficulties to meet the OECD's standards in terms of democracy and of constituting a market economy or may simply favour to stay outside the organisation. Simultaneously, the activities of the OECD in fighting tax fraud or the well mediatised initiative in assessing the quality of schooling (i.e. the PISA tests) prove the global importance of the organisation.

The Financial Action Task Force (on Money Laundering) (FATF), also known by its French name, Groupe d'action financière (GAFI), is an intergovernmental organization founded in 1989 on the initiative of the G7. The purpose of the FATF is to develop policies to combat money laundering and terrorism financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris. The objectives of the FATF[293] are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislator and regulatory reforms in these areas. The FATF has developed a series of recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They help also ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and most recently in 2012. The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and countermeasures, and promotes the adoption and implementation of appropriate measures globally. In collaboration with other international stakeholders, the FATF works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse. The FATF's decision making body, the FATF Plenary, meets three times per year.

The International Energy Agency (IEA) was founded in November 1974 as an independent unit of the OECD where the IEA keeps its headquarters. According to its mission statement,[294] the IEA works to ensure reliable, affordable and clean energy for its 29 member countries and beyond. Created in response to the 1973/74 oil crisis, the IEA's initial role was to help countries co-ordinate a collective response to major disruptions in oil supply through the release of emergency oil stocks to the markets. While this continues to be a key aspect of its work, the IEA has evolved and expanded. It is at the heart of a global dialogue on energy, providing authoritative statistics, analysis and recommendations. Today, the IEA's four main areas of focus are: - Energy security: Promoting diversity, efficiency and flexibility within all energy sectors; Economic development: Ensuring the stable supply of energy to IEA member countries and promoting free markets to foster economic growth and eliminate energy poverty; - Environmental awareness: Enhancing international knowledge of options for tackling climate change; and - Engagement worldwide: Working closely with non-member

[293] The following text is from http://www.fatf-gafi.org/pages/aboutus/

[294] http://www.iea.org/aboutus/whatwedo/

countries, especially major producers and consumers, to find solutions to shared energy and environmental concerns.

To portray the IEA in this chapter on global finance institutions is not too wrong. Oil revenues were a major source of structural global iinancial imbalances (see the debate on the recycling of the petro-dollars in the 70'), and may continue to do so. Sovereign Wealth Funds, dealt with in section 5 below, raise also the question where excess earnings of countries may be invested. It was the ambition of the OECD to liberalise capital movements at least among those nations that can afford to do so. The OECD codes which we portray in the next section are open to 3d countries as well.

3 The OECD's Code of Liberalisation of Capital Movements

For over 50 years, the Code of Liberalization of Capital Movements[295] set up by the Organisation for Economic Co-operation and Development (OECD) establishes obligations for high levels of openness for transactions affecting the capital account. Not all transactions are treated in the same manner.

A standstill applies to restricting the operations according to List A:

- Direct investment and liquidation of direct investment
- Operations in securities on capital markets
- Collective investment securities
- Credits directly linked with international commercial transactions or the international rendering of services
- Financial credits and loans.
- Sureties, guarantees and financial back-up facilities
- Operation of deposit accounts by non-residents of accounts of resident institutions
- Life assurance
- Personal capital movement except gaming
- Physical movement of capital assets
- Disposal of non-resident-owned blocked funds

Finally, the sale of real estate figures on List A, while the purchase is on List B.

For transactions according to List B no standstill applies. On this list figure also the following transactions:

- Operations on money markets
- Negotiable instruments and non-securitised claims in cases where no resident participates in the underlying commercial or service transaction
- Financial back-up facilities in cases not directly linked to international trade, international current invisible operations and international capital movement operations or where no resident participates in the underlying international operation concerned
- Operation of deposit accounts by residents of accounts of non-resident institutions
- Operations in foreign exchange.

These far-reaching commitments are subject to substantive safeguard provisions, however, as the following list shows. Causes of derogation are

a) if the country's economic and financial situations justifies such a course;

b) if any measures taken or maintained […] result in serious economic and financial disturbance;

c) if the overall balance of payments [...] develops adversely at a rate and in circumstances […] which the country considers serious […].

Measures introduced making use of the derogation clause must abide by standards of:

- *Transparency and accountability*: Measures should be notified and are subject to scrutiny, meaning they are open for international discussion. An adherent invoking the derogation clause must justify the course of action undertaken. It must provide information to other adherents and subject its measures and policies to examination by the Code's Forum.
- *Non-discrimination among adherents*: All adherents have the same right to benefit from liberalisation measures of others. Measures should not discrimination among investors from different countries.
- *Proportionality*: Restrictions on capital movements are measures of last resort, when other policy responses are insufficient to effectively achieve the objective pursued; they should avoid unnecessary damage, especially when they have a bearing on the interests of another country; the severity of restrictions should be proportional to the problem at hand, with measures disrupting business as little as possible and in particular minimising adverse impacts on operations such as FDI and commercial credit; restrictions on capital move-

[295] See http://www.oecd.org/investment/investment-policy/codes.htm

ments should be conceived as temporary, accompanied by indications and expected timing for their phasing out.

It is also worth mentioning that the Treaty on the Functioning of the European Union (EU) has established free capital movements as a binding obligation among EU members and between EU members and third countries.

4 Is the liberalisation of capital flows still on the institutional agenda?

Global capital flows have increased dramatically in the last decade, from an average of less than 5 percent of global GDP during 1980-1999 to a peak of about 20 percent by 2007. In the past, countries' capital accounts have ranged from almost completely closed to completely open and, while most countries have moved in the direction of greater openness, wide differences remain. The issue of when, how, and how much to liberalize capital flows has been one of the most contentious in the global economic policy debate for decades. Against this background, on 14 November 2012, the IMF released an institutional view on the liberalization and management of capital flows.[296] The intention was to dispose of a comprehensive, flexible, and balanced view on the management of global capital flows to help give countries clear and consistent policy advice. Below, we reproduce the executive summary:

“EXECUTIVE SUMMARY

Capital flows have increased significantly in recent years and are a key aspect of the global monetary system. They offer potential benefits to countries, but their size and volatility can also pose policy challenges. The Fund needs to be in a position to provide clear and consistent advice with respect to capital flows and policies related to them. In 2011, the International Monetary and Financial Committee (IMFC) called for further work on a comprehensive, flexible, and balanced approach for the management of capital flows. This paper proposes an institutional view to underpin this approach, drawing on earlier Fund policy papers, analytical work, and Board discussions on capital flows. The main points are as follows:

- Capital flows can have substantial benefits for countries, including by enhancing efficiency, promoting financial sector competitiveness, and facilitating greater productive investment and consumption smoothing.
- At the same time, capital flows also carry risks, which can be magnified by gaps in countries‘ financial and institutional infrastructure.
- Capital flow liberalization is generally more beneficial and less risky if countries have reached certain levels or thresholds of financial and institutional development. In turn, liberalization can spur financial and institutional development.
- Liberalization needs to be well planned, timed, and sequenced in order to ensure that its benefits outweigh the costs, as it could have significant domestic and multilateral effects. Countries with extensive and longstanding measures to limit capital flows are likely to benefit from further liberalization in an orderly manner. There is, however, no presumption that full liberalization is an appropriate goal for all countries at all times.
- Rapid capital inflow surges or disruptive outflows can create policy challenges. Appropriate policy responses comprise a range of measures, and involve both countries that are recipients of capital flows and those from which flows originate. For countries that have to manage the macroeconomic and financial stability risks associated with inflow surges or disruptive outflows, a key role needs to be played by macroeconomic policies, including monetary, fiscal, and exchange rate management, as well as by sound financial supervision and regulation and strong institutions. In certain circumstances, capital flow management measures can be useful. They should not, however, substitute for warranted macroeconomic adjustment.
- Policymakers in all countries, including countries that generate large capital flows, should take into account how their policies may affect global economic and financial stability. Cross-border coordination of policies would help to mitigate the riskiness of capital flows.
- The Fund is well-placed to provide relevant advice and assessments to its members in close cooperation with country authorities and other international organizations. This paper clarifies the trade-offs between policy options for dealing with capital flows, harnessing the benefits of capital mobility, and addressing the implications of capital flow management for global economic and financial stability.

[296] http://www.imf.org/external/pp/longres.aspx?id=4720

- The proposed view will guide Fund advice to members and, where relevant, Fund assessments in the context of surveillance. It does not, however, alter members‘ rights and obligations as this would require an amendment of the Articles of Agreement. Members‘ rights and obligations under other international agreements also remain unaffected. “

The most remarkable statement is that in certain circumstances, capital flow management measures (CFM) can be useful for supporting macroeconomic policy adjustment and safeguarding financial system stability. According to the report, CFMs can not only help gain time to make a thorough assessment of the measures which need to be taken, CFMs can also have a role in circumstances such as the following:

- when the room for adjusting macroeconomic policies is limited,
- when the policy steps or the macroeconomic adjustments require time to take effect,
- when an inflow surge raises risks of financial system instability.

The report formulates also a number of caveats, saying that from a practical standpoint, experience suggests that in most cases there will be a need (as well as room) to adjust macroeconomic and structural policies. Only rarely would CFMs be the sole warranted policy response to an inflow surge. CFMs should not substitute for macroeconomic policies that are needed for warranted external adjustment, domestic macroeconomic stability, and effective operation of the international monetary system. Even when CFMs are desirable, their likely effectiveness remains a key consideration. While the choice of which CFM to use would depend on the expected effectiveness and efficiency, the design and implementation of CFMs should be transparent, targeted, temporary, and preferably non-discriminatory.

5 Sovereign Wealth Funds[297]

A Sovereign Wealth Fund (SWF) is a state-owned investment fund investing in real and financial assets such as stocks, bonds, real estate, precious metals, or in alternative investments such as private equity funds or hedge funds. Sovereign wealth funds invest globally. Most SWFs are funded by revenues from commodity exports or from foreign-exchange reserves held by the central bank. SWFs are typically created when governments have budgetary surpluses and have little or no international debt. It is not always possible nor desirable to hold this excess liquidity as foreign exchange reserves or to channel it into immediate consumption, and this for the following reasons:

- Foreign exchange reserves are subject to the legislation of the Central Bank and should be invested in pursuit of macroeconomic policy goals. This will usually only result in a small yield and macro-economic policy coordination imposes some restraint on central banks in reshuffling their long positions in near-money assets, in using futures markets or in going short.
- Immediate consumption is not indicated, even in poor countries, due to the properties of natural resource revenues since an unstable spending stream has the potential to disturb growth domestically. The lack of stability in these revenues is rooted in the high volatility of resource prices, in the unpredictability of extraction (also in the form of spillovers from other world regions), and in the exhaustibility of resources;

Accordingly, there are two types of funds: saving funds and stabilization funds:

- Stabilization SWFs are created to reduce the volatility of government revenues, i.e. to counter the adverse effect on government spending and the national economy the boom-bust cycles' on commodity markets generate.
- Savings SWFs build up savings for future generations by using in particular also more profitable, longer term investments which usually do not belong in a portfolio of a central bank. One such fund is the Government Pension Fund of Norway.

As these asset pools continue to expand in size and importance, so does their potential impact on various asset markets. A considerable number of countries, not least the US,[298] worry that invest-

[297] The text follows the indications in http://en.wikipedia.org/wiki/Sovereign_wealth_fund as of 22 May 2015. The Sovereign Wealth Fund Institute, a private consulting firm based in Las Vegas, provides also useful information.

[298] In the US, the Exon-Florio provision of 1988 (strengthened 2008) grants the President the authority to block proposed or pending foreign acquisitions of “persons engaged in interstate commerce in the United States” that threaten to impair the national security. This provision came under intense scrutiny with the proposed acquisitions in 2006 of major operations in six major U.S. ports by Dubai Ports World and of Unocal by the China National Offshore Oil Corporation (CNOOC). For more

ment by foreign SWFs might compromise national security, arguing that the purpose of the investment might be to secure control of strategically important industries for political rather than financial gain. The problem arose that whence one country started to limit investment by SWFs, other countries feared that they would now have to absorb more of the SWFs' money, affecting ownership structures in their economy in a non-desirable way from a political point of view.

Also to stem this problem of narrowing investment opportunities, the SWFs adopted guiding principles for their behaviour, the Santiago Principles (see box), and established an organisation, the International Forum of Sovereign Wealth Funds, which discloses information on these funds and monitors them to a certain extent.[299]

The Santiago Principles

In September 2008, at a summit in Chile, the International Working Group of Sovereign Wealth Funds—consisting of the world's main SWFs and the precursor of the IFSWF—agreed to a voluntary code of conduct first drafted by the IMF and then forwarded to a committee of the IMF-Board for information. It is made up of 24 principles. The principles call for a sound and effective legal framework (1), stating clearly and officially the policy purpose of the fund (2). Domestic activities shall be closely coordinated with the domestic fiscal and monetary authorities (3) and the SWF's general approach to funding, withdrawal, and spending should be clear and publicly disclosed (4). Data pertaining to the SWF should be reported on a timely basis to the owner and statistical authorities (5). The governance framework should establish a clear and effective division of roles and responsibilities (6) and members of its governing body(ies) appointed in accordance with clearly defined procedures (7). The governing body(ies) should act in the best interests of the SWF (8), and the operational management of the SWF should implement the SWF's strategies in an independent manner (9) and in accordance with an established accountability framework (10). Recognized accounting standards shall be used in a consistent manner (11) and financial statements audited annually (12). Professional and ethical standards should be clearly defined (13) and the SWF's operational management should be based on economic and financial grounds (14) and in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate (15). The governance framework and objectives, the operational independence of the SWF's management and relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries (16) (17). Sound portfolio management principles with the aim to maximize risk-adjusted financial returns should be applied to attain defined objectives (18) (19). The SWF should not seek or take advantage of privileged information (20) and the SWFs shall view shareholder ownership rights as a fundamental element of their equity investments' value and to this end disclose the key factors guiding its exercise of ownership rights (21). Risk assessment should be in place (22) and performance reported to the owner according to clearly defined principles or standards (23). Finally, a process of regular review of the implementation of the principles should be engaged in, by or on behalf of the SWF (24).

Compiled by the author from http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf

Assets under management of SWFs reached in 2013 US-$ 5.78 trillion. There was an additional US-$ 7.2 trillion held in other sovereign investment vehicles, such as pension reserve funds, development funds and state-owned corporations' funds and US-$ 8.1 trillion in official foreign exchange reserves. Taken together, governments of SWFs, largely those in emerging economies, have access to a pool of funds totalling US-$ 20 trillion (the annual GDP of the US reached US-$ 17.4 trillion in 2014).

SWFs funded primarily out of oil and gas exports totalled US-$ 4.29 trillion by the end of 2014 while non-oil and gas SWFs totalled US-$ 2.82 trillion. Non-commodity SWFs are typically funded by a transfer of assets from official foreign exchange reserves, and in some cases from government

information see e.g. Congressional Research Services (author James K. Jackson): The Exon-Florio National Security Test for Foreign Investment March 29, 2013.

299 See International Forum of Sovereign Wealth Funds (IFSWF): The Santiago Principles: 15 case studies - How IFSWF Member's implement the Santiago Principles, published at the 6th meeting of the IFSWF's Members at Doha, November 2014. See www.ifswf.org/pst/SantiagoP15CaseStudies1.pdf

budget surpluses and privatisation revenue. Asian countries account for the bulk of such funds.

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An important point to note is the SWF-to-Foreign Exchange Reserves Ratio, which shows the proportion a government has invested in investments relative to currency reserves. According to the SWF Institute, most oil-producing nations in the Persian Gulf have a higher SWF-to-Foreign Exchange Ratio — for example, the Qatar Investment Authority (5.89 times) compared to the China Investment Corporation (0.12 times) — reflecting a more aggressive stance to seek higher returns.[300]

Evidently, more of these funds could in future be channelled towards funding the development of infrastructures where there is a global demand

[300] This close connection to foreign exchange reserves is an explanation for the involvement of the IMF in the elaboration of the Santiago principles.

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