WORKING PAPER - 4

# Agriculture and NAMA Negotiations

## Searching for the Landing Zone

Centad
Centre for Trade & Development

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Key Words : Agriculture, NAMA, OTDS, Swiss formula, Tariff, WTO

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# Foreword

The Hong Kong (HK) Ministerial once again reinforced the fact that Development remains the missing link in the Doha Development Agenda, the rhetoric notwithstanding. Developed countries sought reciprocal benefits and were unwilling to pay adequate attention to development concerns. The European Union (EU) damaged efforts for an early decision on the final date for elimination of export subsidies, until the last day of the Ministerial. In addition, instead of 2010, which was the call by almost all countries including the United States (US), the EU pushed the date for elimination of subsidies to 2013. Similarly, the US was unwilling to provide, without safeguards, duty-free quota-free (DFQF) access to least developed countries (LDCs). On the final day, they agreed to provide access to 97 percent of tariff lines, effectively excluding exports from LDCs. In NAMA, the tariff reduction formula, which is the core modality, still remains ambiguous. Similarly, flexibilities in NAMA are still under negotiation and efforts are on to link it with the tariff reduction formula.

In this context, as the time to establish the actual modalities in Agriculture and Non Agriculture Market Access (NAMA) draws precariously close, this paper takes a critical look at the HK Ministerial text on Agriculture and NAMA. It analyses the outcome of the HK Ministerial meeting on the touchstone of development. On the basis of this analysis the paper suggests some specific and important negotiating inputs from the perspective of developing countries. In Agriculture, it calls developed countries to reduce their trade distorting subsidies by 2010, suggests a tariff reduction formula along the proposal made by the G20. In NAMA, the paper moots a bold approach to interpret the text on the tariff reduction formula in order to have the formula proposed by Argentina, Brazil and India (ABI). It also asks for a differential tariff binding non-linear mark up for different tariff lines.

The conclusions of the paper are essentially based on an interpretation of the HK Ministerial Declaration. More research is needed in this field to comprehensively reflect the concerns and interests of developing countries. Centad is committed to continuing with its policy research to promote the interests of least developed and developing countries, specially those of South Asia, in the multilateral trade negotiations. It proposes to publish more papers reflecting the concerns and interests of the least developed and the developing countries, specially those in the South Asian region.

I hope all stakeholders will find this paper useful.

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# Abbreviations

| | | |
|---|---|---|
| AB | : | Appellate Body |
| AMS | : | Aggregate Measurement of Support |
| AoA | : | Agreement on Agriculture |
| ABI | : | Argentina, Brazil and India |
| ATR | : | Average Tariff Rate |
| BTR | : | Bound Tariff Rate |
| CAP | : | Common Agricultural Policy |
| DFQF | : | Duty-Free Quota-Free |
| EU | : | European Union |
| FICCI | : | Federation of Indian Chambers of Commerce and Industry |
| HK | : | Hong Kong |
| HS | : | Harmonised System |
| IATP | : | Institute of Agriculture and Trade Policy |
| LDCs | : | Least Developed Countries |
| LTFR | : | Less Than Full Reciprocity |
| MFN | : | Most Favoured Nation |
| NAMA | : | Non Agriculture Market Access |
| OTDS | : | Overall Trade Distorting Support |
| SP | : | Special Products |
| SSM | : | Special Safeguard Mechanism |
| T&C | : | Textile and Clothing |
| US | : | United States |
| WTO | : | World Trade Organisation |

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# Executive Summary

The VI ministerial meeting of the World Trade Organisation (WTO) in Hong Kong (HK) from 13-18 December 2005 was projected as a 'success'. This projection was done mainly because nobody wanted another official 'failure' of a WTO ministerial meeting. Hence, the ministers and negotiators worked hard to come out with a declaration, which although far from satisfactory, has certainly kept the hopes alive.

The projected success of the HK Ministerial meeting is largely a myth, as except for some tiny steps, the ministerial meeting has failed to deliver on crucial issues such as the fast track removal of trade distorting subsidies in agriculture and providing better market access to developing countries by lowering tariff and non-tariff barriers. HK pushed most of the difficult issues like the quantum of cuts in domestic subsidies in agriculture, tariff reduction formula in both agriculture and Non Agriculture Market Access (NAMA), the number of tariff lines to be designated as special products, to the future. Even simpler things like an end date for the elimination of export subsidies were dragged until the very last moment before finally settling it. In short, HK in terms of a significant correction to the imbalances in the global trading regime barely scratched the surface.

One of the major imbalances in the global trade is on account of the distorted nature of agricultural trade. The distortions stem from the gigantic subsidies that are given by developed countries to their farmers, which in turn allow them to sell their produce below cost of production (agricultural dumping) in international markets. This depresses the prices and does not make it remunerative enough for farmers of smaller and poorer countries to sell their produce in international markets.

Developing countries want a level playing field in agriculture. This can be achieved only if developed countries agree to reduce their trade distorting domestic subsidies. In this regard, the July framework agreement of 2004 provided for cutting the trade distorting subsidies from the bound level (maximum permissible subsidy that a country can grant). However, cutting the subsidies from the bound level may not be effective, as there is a huge variance between the bound and applied level of subsidies (actual level of subsidies that are being given). In some cases, like Japan and Canada, this gap is as high as 83 and 74 percent respectively. Hence, even a reduction of 60 to 70 percent in subsidies from the bound level would prove ineffective, as it will not succeed in bringing down the actual subsidies. Developing countries have been arguing that there should be a very steep reduction in the subsidy levels from the bound rates in order to bring down the actual level of subsidies. The reduction from the bound levels should be such that the new bound levels (maximum permissible) are much less than the present applied levels (actual level). This will ensure that the actual subsidies in developed countries are also reduced. In this regard, HK Declaration states that disciplines will be developed to ensure effective cuts in domestic subsidies. This window should be used by developing countries to make sure that developed countries drastically cut their trade distorting domestic subsidies.

Developing countries should also ensure a more effective disciplining of the green box subsidies. However, it seems that in HK, developing countries put more emphasis on having policy space to use the green box subsidies themselves rather than stressing on an end to the misuse of these subsidies by developed countries. The elimination of export subsidies by the end of 2013 is only a marginal

gain for developing countries, as export subsidies constitute a minuscule portion of the overall trade distorting subsidies. Moreover, even this miniscule portion will be removed in a time span of seven years as against the initial proposal of eliminating it by 2010.

HK witnessed some positive development on the issue of Special Products (SP) and Special Safeguard Mechanism (SSM). It states that developing countries will now be able to use the SSM and also self designate certain products as SP. However, the number of tariff lines that can be designated as SP is yet to be decided.

In NAMA, there was no convergence on the core modality of the tariff reduction formula. HK Declaration states that there will be a 'Swiss formula with coefficients'. This could be interpreted by countries to reject the simple Swiss formula with two coefficients (one for developed and one for developing countries) and accept the formula that has more than one coefficient embedded in the formula on the lines of the proposal made by Argentina, Brazil and India (ABI) or the Caribbean group of countries. This type of formula will ensure 'less than full reciprocity' (LTFR) for developing countries and also elimination of tariff peaks and tariff escalation on products of interest to developed countries.

HK also witnessed the reiteration of the fact by developing countries that flexibilities in NAMA, whereby certain tariff lines can be left out of the tariff reduction formula, should be a stand-alone provision. It should not be linked to the tariff reduction formula in any case as was suggested by some developed countries.

There was some movement in HK on treatment of unbound tariff lines. HK Declaration states that all the unbound tariff lines will be marked-up by using a non-linear mark-up and then subjected to tariff reduction. In this regard, developing countries should negotiate for different mark-ups for different tariff lines. Especially tariff lines that have lower applied tariffs should be marked-up at higher bound rates. Also, the new marked-up bound tariff rates should have a 'cool-off' period before it is subjected to a tariff reduction formula. This tariff reduction formula should be different from the tariff reduction that will be used for reducing the already bound tariff lines.

There is a tough battle ahead for developing countries. They have to negotiate very hard and should not give concessions to developed countries till concessions from developed countries are forthcoming. Developing countries also need to stand united against any attempts by developed countries to break their unity.

# 1. Introduction

The ministerial meeting of the World Trade Organisation (WTO) at Hong Kong (HK) attempted to put global trade talks back on track. It is being projected as a 'success' mainly because nobody wanted another failure of the WTO ministerial meeting. Another fiasco, as happened at Seattle and Cancun, could have spelt trouble for the multilateral trading framework.

In order to analyse the projected 'success' of the ministerial meeting it is important to understand the context of the meeting. The expectations from the ministerial meeting were low to start with. The differences between different contesting parties were too wide for any major agreement to be reached. In the run up to the ministerial, several deadlines were missed. Many even predicted that another 'Cancun' was in the offing. Indeed, the WTO secretariat itself had scaled down the expectations from the ministerial. Given this backdrop, there was all round feeling that the HK Ministerial meeting would not be able to deliver any significant outcome. Nevertheless, HK did come up with a declaration, and succeeded although only just in keeping the hopes of the developing world alive. The HK Declaration, while pushing key decisions to a future date, did lay down a road map and came up with another set of deadlines in order to establish the modalities with the objective of finishing the present round of talks by the end of 2006.

It is important to have a reality check on the official projection of HK being a 'success'. Questions have been raised about whether or not the member countries, especially developed countries, are serious about meeting the deadlines proposed in HK. It is also debatable whether the HK Ministerial contributed in mainstreaming the 'Development' dimension of the global trade negotiations or was it yet another failed attempt to correct the inherent imbalances in global trade?

This paper attempts to answer some of these questions. It looks at the two most important and contentious issues in global trade, namely agriculture and Non Agriculture Market Access (NAMA), and tries to find out what HK did finally achieve as seen from the perspective of developing countries.

# 2. Agriculture

Agriculture was, has been and continues to be the most contentious issue in the entire history of the multilateral trade negotiations in spite of having a share of only 8.8 percent in world trade. Agriculture is sensitive for most developing countries, as it is more a livelihood issue than a commercial issue, unlike in developed countries. Hence, it has always occupied the maximum space on the negotiating agenda.

All developing countries are circumspect while negotiating on agriculture, as they are fully aware that a bad deal on agriculture will jeopardise the survival of millions of people in their countries. A bad deal on agriculture will imply that developed countries will continue to illegally subsidise their agriculture produce and dump their produce in international markets by selling at prices that are below the cost of production. This makes it difficult

**The ongoing negotiations on agriculture and other issues, which were launched in Doha in November 2001, have an important mandate to correct the rigged trade rules.**

for farmers from developing countries to compete with the developed country farmers in domestic and international markets.

There is ample evidence to demonstrate the distorted nature of global agricultural trade. According to the Institute for Agriculture and Trade Policy (IATP), the US has been dumping cotton in international markets since 1990. The dumping margin (difference between the selling price and cost of production) has ranged from 32 percent to 47 percent from 1990 to 2003, touching 63 percent and 65 percent in 2001 and 2002 respectively.[1] This enormous export dumping has depressed prices of cotton in the international markets and consequently impaired livelihoods of millions of farmers across West and Central Africa. Since 2001, when the fall in cotton prices became very evident, Africa has been losing on an average US$ 441 million a year because of the distorted cotton trade. Since 2003, the West and Central African producers have suffered export losses of about US$ 382 million. According to a study done by Oxfam, the US government provided subsidies worth US$ 490 million between 1995 and 2003. Due to these generous subsidies, Riceland, a US-based agribusiness firm, has been exporting rice to 75 countries. Further, these subsidies made US the third largest exporter of rice in 2003, after Thailand and Vietnam, although producing rice in US is almost two times costlier than it is in Thailand and Vietnam.[2]

The ongoing negotiations on agriculture[3] and other issues, which were launched in Doha in November 2001, have an important mandate to correct the rigged trade rules including those relating to distortions in agricultural trade. For the developing countries an opportunity missed now would mean that the skewed nature of agricultural trade will continue for many more years and the interests of farmers will continue to be vulnerable as they will be denied market access, will not be able to sell their produce in international markets at competitive prices, and will face competition artificially induced by the colossal subsidies of developed countries. The journey from Doha to HK has been a bumpy ride. What has emerged from the review process by way of gains is negligible and in the bargain much negotiating time has been lost. It is in this context that the HK Ministerial meeting was seen as an opportunity to move towards changing the distorted nature of global agricultural trade. However, HK witnessed only partial success in agriculture with many of the difficult questions being pushed to future.

There are many complex issues involved in the agriculture negotiations. This paper, however, would focus on some of the critical issues relating to domestic support, market access and export subsidies. It makes an attempt to estimate the impact of the HK Declaration on developing countries and least developed countries (LDCs) and also makes a modest attempt to identify the roadmap ahead using the HK Declaration as the reference point.

## 2.1 Domestic Support

Domestic support is the subsidy support measure given by the national governments to their farmers in agriculture. It is divided into three main groups or 'boxes', namely, the amber box, blue box and green box.

[1] Institute of Agriculture and Trade Policy (IATP), United States Dumping on World Markets, http://www.tradeobservatory.org/library.cfm?refID=48538 (visited on 10 March 2006).

[2] Oxfam, Kicking Down the Door, http://www.maketradefair.com/en/assets/english/kickingreport.pdf (visited on 12 March 2006).

[3] Paragraph 13 of the Doha Ministerial Conference, (WT/MIN (01)/DEC/W/1, gives the mandate to negotiate for reviewing the Agreement on Agriculture and also forms the basis for the present negotiations on agricultural trade.

TABLE 1

**The Overall Trade Distorting Support (OTDS) of developed countries (US$ million)**

| Country | Bound Level | Applied Level | Variance (percentage) |
|---|---|---|---|
| US | 44,118 | 23,299 | 47 |
| EU | 93,503 | 62,679 | 32 |
| Japan | 43,622 | 7,096 | 83 |
| Canada | 5,412 | 1,391 | 74 |

*Note:* The data in the table correspond to the average of the last three years of notified support for each region or country: EU and US - 1999-2001, Japan - 2000-02, Canada - 1998-2000.[5]
*Source:* World Bank 2006

## *Amber Box*

The subsidies that fall in the amber box are trade-distorting subsidies and hence are subject to reduction commitments. The amber box subsidy is technically called the Aggregate Measurement of Support (AMS), which is measured mainly in terms of the difference between the domestic price and international price. This AMS is subject to reduction because it distorts trade. Similarly, the Overall Trade Distorting Support (OTDS), which is the sum of amber box, blue box and *de minimis* subsidies[4], is also subject to reduction commitments. In the discussion that follows we will look at the levels of OTDS in developed countries, what the HK Declaration proposes to do and the impact of the declaration on the current levels of OTDS given by developed countries.

The trade distorting subsidies of developed countries have acted as a major hindrance in the path of developing countries towards realising the development dimensions of the multilateral trading regime. The figures in Table 1 indicate that there is a major gap between the bound level (maximum permissible level of subsidy) of the OTDS and the applied level (actual level of subsidy given). In some cases, for instance in Japan and Canada, the difference is as huge as 83 and 74 percent respectively. These figures and the variance reveal many things. First and foremost it can be said that even without going up to the maximum permitted level of subsidy, the subsidies granted by these countries are distorting trade, as we have seen in the examples above. In other words, in the case of US, even a subsidy of US$ 23,299 million (the actual level of subsidies given), which is 47 percent less than the maximum permitted level of subsidy, is distorting trade. For instance, even with subsidies less than the bound level, the US has been dumping cotton in the international markets as discussed above. So, if the US goes on to give a subsidy of US$ 44,118 million, which is legally permissible, then it can further distort agricultural trade (for example sell cotton at prices much below the cost of production).[6]

The other important point revealed by these figures is that if reductions are made from the bound level, the actual level of subsidies may remain unaffected. In fact, paragraph 7 of Annex A of the July framework agreement talks of reducing overall support from the bound level and not applied level. However, in the case of the US, even if there is a reduction of 45 percent in the bound level of US$ 44,118 million, the new bound level of subsidy will be US$ 24,265 million, which is still more than the actual or applied level of subsidy of US$ 23,299 million. Hence, there will not be any reduction whatsoever in the applied

[4] *De minimis* subsidies are the maximum ceiling on trade distorting domestic support that is not subject to reduction commitments. De minimis subsidy for developed country should not exceed 5 percent of the total value of agricultural production both for specific and non-specific categories. These values are 10 percent for developing countries.

[5] Harry de Gorter and J Daniel Cook, 'Domestic Support in Agriculture: The Struggle for Meaningful Disciplines' in Richard Newfarmer (eds), 'Trade, Doha and Development' (World Bank: 2006), 100.

[6] Some may argue that if US gives subsidy equivalent to the permitted bound level, then it is not necessary that it will start selling cotton at a cheaper price in the international market, as the subsidy specific to cotton may not increase. This may be true. However, the idea here is not to establish a direct link with any possible increase in subsidy in US to its bound level and the price of cotton in the international markets. The purpose is to show how potential increases in subsidies to the bound level may further foster dumping in international markets and hence distort trade.

level of subsidies. In such a scenario the US can actually increase its present applied level of subsidy from US$ 23,299 million to the newly found bound level of US$ 24,265 million.

So, a reduction of 45 percent in the bound level of the OTDS will have no impact on the existing applied level of subsidy in these countries except in the European Union (EU) (See Figure 1). The EU is the only country where the new bound level will be less than its present applied level of subsidy. However, Japan, Canada and the US would continue to be in a position to actually increase their present level of applied subsidies. Indeed, Japan may double its present levels of applied subsidies even after the reduction of 45 percent from the bound level.

This brings us to the important question of the methodology of reducing subsidies in order to make these cuts effective.[7] For this to happen, cuts from the bound levels need to pegged appropriately very high. It should be as high as necessary not just to consume the 'water'[8] between the bound and applied level but also to have a new bound level of subsidy, which is substantially less than the present applied level of subsidy.

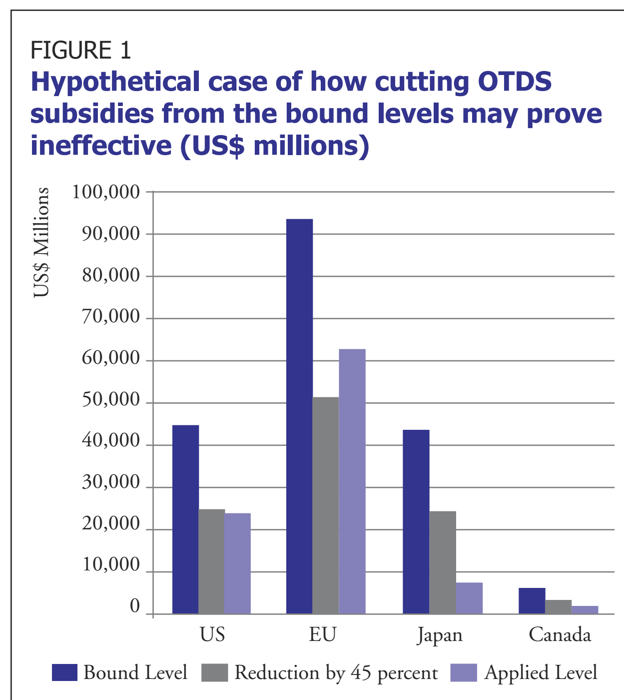


FIGURE 1
**Hypothetical case of how cutting OTDS subsidies from the bound levels may prove ineffective (US$ millions)**

*Source:* Table 1 and Author's calculations

With this as the objective, G20 had proposed that for OTDS of more than US$ 60 billion, the reduction should be 80 percent; for support between US$ 10 and 60 billion, the reduction should be of 75 percent and support less than US$ 10 billion should be reduced by 70 percent. However, this proposal has not been adequately reflected in the HK Declaration. Paragraph 5 of the HK Declaration talks of reducing trade distorting domestic subsidies. It states that:

1. There will be three bands for reductions in Final Bound Total AMS and in the overall cut in trade-distorting domestic support.
2. There will be higher cuts in higher linear bands.
3. Developing country members will be in the bottom band.
4. Disciplines will be developed to achieve effective cuts in trade distorting domestic support consistent with the framework.

Paragraph 5 reiterates what has been said by the July framework agreement that reductions have to be undertaken from the bound level. However, it also states that disciplines will be developed to ensure effective cuts in these trade-distorting subsidies. The talk of effective cuts is a partial reflection of the proposal made by G20, and has given hope of having new bound levels that are less than the present levels of applied subsidies.

Paragraph 8 of Annex A of the HK Declaration gives an indication of the levels of cuts that countries are willing to take (Table 2). The range below indicates the degree of divergence between countries. The reduction cut ranges from 31 to 70 percent for the 1st band. The rates of reduction in subsidies that G20 has proposed are reflected as the upper limits in Table 2.

[7] 'Effective' here means the new subsidy level, after reduction, should be much less than the presently applied level of subsidy.
[8] The difference between bound and applied level of subsidy. If the difference between the bound and the applied level is high it means there is a lot of 'water' between the bound and the applied rates.

If we place the figures from Table 1 in Table 2, then the US and Japan will fall in Band 2, the EU will fall in Band 1 and Canada will fall in Band 1. In order to see how effective the reduction will be based on the cuts proposed in Table 2, let us apply these cuts to the bound level subsidy of the four developed countries.

TABLE 2

**Range of cuts in OTDS that countries are willing to undertake**

| Bands | Thresholds (US$ billion) | Cuts (percentage) |
|---|---|---|
| 1 | 0-10 | 31-70 |
| 2 | 10-60 | 53-75 |
| 3 | >60 | 70-80 |

*Source:* Paragraph 8; Annex A, HK Ministerial Declaration

The simulations in Table 3 are for both the minimum and maximum subsidy reduction rates given in Table 2. Figures in Table 3 very clearly reveal that even a reduction of 53 percent in the bound subsidy level of the US will not lead to any substantial reduction in the present applied levels of subsidy in the US. Even after reduction, the bound level comes down to US$ 20,736 million, which is only marginally lower than the present applied level of subsidy. This reveals the flaw of cutting subsidies from the bound level. This type of cut will not result in any developmental gains to developing countries. Even a reduction of 75 percent reduces the bound subsidy level to US$ 11,030 million, which in reality is a reduction of 50 percent from the present applied levels. Even this reduction cannot be called effective. Paragraph 5 of the HK Declaration states that disciplines have to be developed to achieve effective cuts in the trade distorting subsidies. However, a cut in the range of 53 to 75 percent cannot be called effective. Similarly, if we take the case of Japan, even a reduction of 75 percent does not bring the bound level of subsidy below the present applied level of subsidy in Japan. The range of cut from 53 to 75 percent will not at all be effective in the case of Japan within the meaning of paragraph 5 of the HK Declaration.

In the case of the EU, a cut of 80 percent in the bound level is an effective cut (See Table 4). However, in the case of Canada, which will fall in Band 1, a cut in the range of 31 to 70 percent is not effective.

On the basis of the above discussion, in order to have effective cuts it is important to propose high reduction rates. Cuts in subsidy can be called effective only if the new subsidies are substantially less than the present level of the applied subsidies. There could be different interpretations of what is a substantial reduction. One of the possible way of

TABLE 3

**Applying the reduction rates given in Table 2 to US and Japan (US$ million)**

| Country | Present Bound Level | Bound Level After Reduction by 53 Percent | Bound Level After Reduction by 75 Percent | Present Applied Level |
|---|---|---|---|---|
| US | 44,118 | 20,736 | 11,030 | 23,299 |
| Japan | 43,622 | 20,502 | 10,906 | 7,096 |

*Note:* The figures for the bound and applied level correspond to 1999-2001 for US and 2000-02 for Japan.
*Source:* Author's calculations from the figures given in Table 2.

TABLE 4

**Applying the reduction rates given in Table 2 to EU (US$ million)**

| Country | Present Bound Level | Bound Level After Reduction by 70 Percent | Bound Level After Reduction by 80 Percent | Present Applied Level |
|---|---|---|---|---|
| EU | 93,503 | 28,051 | 18,701 | 62,679 |

*Note:* The bound and applied levels of data correspond to 1999-2001 for EU.
*Source:* Author's calculations from the figures given in Table 2

defining substantial reduction in subsidies could be to cut the present bound levels in such a manner that the new bound levels are at least 50 percent of the present applied level of subsidies. In other words, a reduction will be called substantial only if it is not more than 50 percent of the level of present applied subsidies. However, it can certainly be less than 50 percent of the present level of applied subsidies.

Although, the proposal given above for reduction in the OTDS is from the bound level, the higher rates of reductions will ensure that these cuts are deep and hence effective. In other words, these deep cuts in the bound levels will ensure that the present applied level of subsidies also comes down significantly. It is also important to have an end date of 2010 for carrying out the reduction in the domestic subsidies. This reduction should be progressive and front loading. In this context it is proposed that the reduction of trade

TABLE 5.1
**Proposal to make cuts in the OTDS effective (US$ billion)**

| Bands | Thresholds (US$ billion) | Cuts (percentage) |
|---|---|---|
| 1 | 0-10 | 70-80 |
| 2 | 10-60 | 77-82 |
| 3 | >60 | 80-85 |

*Source:* Author's proposal

distorting domestic support should be implemented in three phases. Sixty percent of this support should be reduced in the first phase. The next 20 percent should be reduced in the second implementation phase and the final 20 percent in the third implementation phase (See Table 5.2). This progressive and front-loading implementation of the process of subsidy reduction would serve to reverse in a significant sense the continued distortion of the agricultural trade.

TABLE 5.2
**Proposal to implement progressive and front-loaded reduction of OTDS**

| Implementation Phases | Subsidy Reduction (percentage) |
|---|---|
| Phase I (2007-2008) | 60 |
| Phase II (2008-2009) | 20 |
| Phase III (2009-2010) | 20 |

*Source:* Author's proposal

## *Blue Box*

The blue box subsidies are an exemption to the general rule that all agricultural subsidies linked to production must be reduced or kept within the *de minimis* levels. They cover domestic subsidies that limit production if such payments are based on fixed acreage or animal numbers.[9]

Many have argued that blue box subsidies are an anomaly in the AoA, as they allow developed countries to evade reforming their domestic subsidies. There are others who state that blue box subsidies are important tools to regulate the agriculture market, which is not self-correcting.[10] However, there are only few countries like the EU, Japan, Norway who give blue box subsidies. The US stopped giving blue box subsidies in 1996.

Developing countries, especially the G20, have been arguing for stricter disciplines for blue box subsidies. However, the US and other developed countries are keen to further expand the ambit of the blue box subsidies. The July framework agreement expanded the ambit of blue box subsidies by including the direct payments to producers that were not tied or linked to production at all. This has been done to include the counter cyclical payments of the US.[11]

In this context, it is important to emphasise that the HK Declaration does not make any attempt to close the window that the US is trying to open. If this window is not closed it will imply that the US can provide counter cyclical payments under the blue box category.[12]

[9] See Article 6.5 of the Agreement on Agriculture
[10] Sophia Murphy and Steve Suppan, The new Blue Box: A step back from fair trade, www.iatp.org (visited on 15 March 2006).
[11] Ibid
[12] Bhagirath Lal Das, 'Imbalance in HK', 2(1), Trading Up, Centre for Trade and Development (Centad), 2006

## *Green Box*

The subsidies falling in the green box are supposedly non-trade distorting and given to farmers under the category such as de-coupled income support, direct payment, research expenditures, training and extension subsidies. This subsidy is described in Annex 2 of AoA (See Box 1). However, these subsidies have proved to be the biggest obstacle on the road to removing trade-distorting subsidies of developed countries.

The provision to have green box subsidies in the AoA is mainly to create escape clause provisions for developed countries to continue to grant subsidies under different disguise forms. Developed countries provide gigantic subsidies to their agricultural sector by camouflaging them as non-trade distorting environment- and livelihood-friendly subsidies. Paragraph 10 of Annex A of the HK Declaration clearly reveals the difference amongst countries on the issue of green box subsidies.

As the figures in Table 6 indicate, the amount of green box subsidy, both for the EU and the US, has increased over the years. In fact, in the US green box support constitutes a major proportion of domestic support (See Table 7). The green box support has been more than the permitted amber box support in the US. This goes to show that developed countries like the US have conveniently moved their trade distorting domestic support from amber box to green box. This box shifting has allowed them to give legitimacy to otherwise illegitimate subsidies. The green box support is not only more than the total amber box support but also more than the permitted limit of amber box (See Table 7). In other words, the amount of subsidy given under the green box category is more than double the amber box support, which is supposedly the most trade-distorting subsidy. The mere quantum of subsidy

BOX 1

**Green box subsidies: A legal perspective**

Paragraph 1 of Annex 2 of AoA states that domestic support measures (subsidies) for which exemption for reduction commitments is claimed shall (binding) meet the fundamental requirement of:

- No or at the most minimal trade distorting effect on production.

  The use of the word 'shall' implies that it is binding and mandatory for countries that immunity from reduction commitments can be claimed only for those subsidies that do not distort international trade at all. In addition to this fundamental requirement, Paragraph 1 of Annex 2 also states that domestic support measures which are exempt from reduction commitments have to fulfill two more conditions:

  1. The support shall be provided through a publicly funded programme and not from consumers. Hence, any subsidy that is drawn from consumers cannot be classified as a subsidy that is exempt from reduction commitments.
  2. The payment shall not have the effect of providing price support to the farmers. In other words, if the payment or transfer of money intends to cover the losses caused due to slump in agricultural prices, then it will be a price support and cannot be immune from reduction commitments and hence not called a green box subsidy.

TABLE 6

**Total green box subsidy of US and EU**

| Country | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| US (US$ billion) | 46.0 | 51.8 | 51.2 | 49.8 | 49.7 | 50.1 | 50.7 |
| EU (€ billion) | 18.8 | 22.1 | 18.2 | 19.2 | 19.9 | 21.8 | - |

*Source:* Harry de Gorter and J Daniel Cook, 'Domestic Support in Agriculture: The Struggle for Meaningful Disciplines' in Richard Newfarmer (eds), 'Trade, Doha and Development' (World Bank: 2006).

Chad E. Hart and John C. Beghin, 'Rethinking Agricultural Domestic Support Under the World Trade Organisation, in Kym Anderson and Will Martin (eds.), '*Agricultural Trade Reform & The Doha Development Agenda*' (World Bank:2006).

**Disciplining the green box subsidy has been one of the major demands of developing countries which was institutionalised in the July Framework agreement.**

under the green box category reveals the gross trade distorting character (violation of the fundamental attribute of a green box subsidy) of this supposedly non trade-distorting subsidy. For US, in 2001, the green box subsidy (US$ 50.7 billions) is more than two times the permitted amber box subsidy (US$ 21.5 billions). Therefore, disciplining the green box subsidy has been one of the major demands of developing countries.

This need was institutionalised in the July Framework agreement. Paragraph 16 of Annex A of the July Framework agreement states that green box criteria in AoA will be reviewed and clarified so as to ensure that green box measures have no or at the most minimal trade distorting effect. Following this provision many developing country groups have made various submissions to reform the green box subsidies. However, these negotiations have not resulted in any substantial change. G20 has made a proposal on reforming the green box subsidy programmes. The main target of the G20 proposal is the de-coupled income support. De-coupled income support is a type of green box subsidy. Payment under this head seeks to de-couple or de-link direct payments from various aspects of their production decisions[13] (See Box 2). However, the practice of developed countries shows that these de-coupled payments are not completely de-coupled or de-linked from the production decisions. They are in one way or the other linked to the production patterns. Hence, this supposedly non trade-distorting subsidy becomes a trade-distorting subsidy by virtue of affecting or influencing the decision of whether to produce or not to produce.

A case in point is the US subsidy or 'amount of payments' under the production flexibility contract and direct payments programme. The US provides these subsidies for the non-production of fruits, vegetables and wild rice. In a dispute between US and Brazil the issue that arose before the Appellate Body (AB) in 2004 was whether these payments under the production flexibility contract and direct payments were de-coupled income support within the meaning of Paragraph 6 of Annex 2 and hence a green box subsidy.

The AB held that these payments were not de-coupled income support and hence not a subsidy under the green box. The AB held that decoupling within Paragraph 6(b) of Annex 2 could be ensured only if the payment was not linked to a positive requirement to produce certain crops or a negative requirement not to produce certain crops.[14] The AB rejected the US contention that it would be a de-coupled income support if it was linked to a negative requirement of not producing certain crops. In fact, the AB said that even a combination of positive and negative requirements would mean

TABLE 7
**Domestic support of US (US$ billion)**

| Category of Subsidy | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| Green box | 46.0 | 51.8 | 51.2 | 49.8 | 49.7 | 50.1 | 50.7 |
| Amber box (Permitted Limit) | 23.1 | 22.3 | 21.5 | 20.7 | 19.9 | 19.1 | 19.1 |
| Amber box (Total) | 7.9 | 7.0 | 7.0 | 15.1 | 24.3 | 24.1 | 21.5 |

*Note:* Amber box (Total) is the sum of all AMS figures (both product specific and non-product specific)

*Source:* Harry de Gorter and J Daniel Cook, 'Domestic Support in Agriculture: The Struggle for Meaningful Disciplines' in Richard Newfarmer (eds), 'Trade, Doha and Development' (World Bank: 2006).

Chad E. Hart and John C. Beghin, 'Rethinking Agricultural Domestic Support Under the World Trade Organisation, in Kym Anderson and Will Martin (eds.), '*Agricultural Trade Reform & The Doha Development Agenda*' (World Bank:2006).

[13] WTO Appellate Body Report, United States – Subsidies on Upland Cotton (US – Upland Cotton), WT/DS267/AB/R, 3 March 2005, para 325.
[14] Ibid

BOX 2

**De-coupled income support in agreement on agriculture**

Paragraph 6 of Annex 2 lists the following eligibility criteria for a payment to the farmer to be called de-coupled income support:

(a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.

(b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

(c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.

(d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.

(e) No production shall be required in order to receive such payments.

there was no de-coupling and hence not a green box support.

In other words, any income support that makes payment contingent to:

1. positive requirement (growing any/certain crops) or
2. negative requirement (not growing any/certain crops) or
3. positive and negative requirements (growing some crops and not growing other crops)

would not be de-coupled income support within the meaning of Paragraph 6(b) of Annex 2 and hence not a green box measure under AoA.

This ruling has shown how countries like the US have been providing trade-distorting subsidies under the guise of provisions like the de-coupled income support. Even after this ruling, the EU has announced plans to put its single farm payment, which is contingent to restrictions on growing fruits and vegetables, under the de-coupled income category of green box.

The G20 also wants the creation of additional disciplines for green box subsidies such as the land reform and stockholding programmes. The intention behind having newer disciplines for the green box subsidies is to allow developing countries to also use these programmes. This aspect of the G20 demand was reflected in the HK Declaration, which talked of covering the subsidy programmes of developing countries in the green box.

The negotiations at HK did not do anything substantial to stop the misuse of green box subsidies. On green box, Paragraph 5 of the declaration states two things:

1. The green box criteria will be reviewed in line with the July Framework agreement.
2. Subsidy programmes of developing countries that are minimally trade distorting are effectively covered in the green box category.

Clearly, this approach would do precious little to address the issue at hand. In fact, it goes to show, that on the issue of green box in HK, developing countries directed their negotiating strategy and energy in getting assurance for their green box subsidy programme. However, as some commentators have noted, developing countries do not have enough financial resources to support green box subsidy programmes[15] and therefore

[15] Bhagirath Lal Das, 'WTO: Bumpy Road to Hong Kong', XL (42), Economic and Political Weekly, 4499 (2005), at 4496.

their efforts at HK should have been to ensure that developed countries effectively disciplined their green box subsidy programmes.

In the coming days, it is going to become important for developing countries to ensure the effective disciplining of the green box subsidy programmes, which should include a very strict definition of de-coupled income support. The WTO ruling has certainly strengthened their hands. As the G20 has proposed, de-coupled income support should be given to farmers on low incomes. The basic intention should be to stop or reform the present system, which allows the farmers to cross-subsidise their production due to the huge quantum of doles that they get from their governments under the garb of green box subsidy.

## 2.2 Market Access

In market access there are three main issues that need to be analysed – the tariff reduction formula, special products and special safeguard mechanism.

### *Tariff Reduction Formula*

The methodology to cut tariffs has been a major issue between developed and developing countries. Developed countries have been constantly demanding that developing countries should bring down their agricultural tariffs so as to allow expansion of market access. However, many developing countries have argued that any drastic or steep reduction of agricultural tariffs is not possible for them because of the sensitivities involved in the agricultural sector. Some developing countries have also argued that reduction in tariffs will not happen until developed countries reduce their agricultural subsidies. From the perspective of most developing countries, tariff reduction has two premises. First, developing countries like India have a defensive interest in agriculture. They are keen to protect their vulnerable farm economies. A tariff-cutting exercise that would impose an undue burden on them through drastic reduction of their tariff rates and harsh adjustment costs would not be tenable. Secondly, the tariff-cutting exercise should lead to substantial improvement in market access for such countries by calling for a steep cut in the tariff rates of developed countries. In other words, from a developing country's perspective, any tariff cutting methodology should be soft on developing countries and hard on developed countries. The negotiating issue would then be the degree of softness and hardness of the tariff cutting methodology. Therefore, for developing countries such as India, any tariff cutting methodology should take into account both these concerns.

There are numerous approaches to tariff reduction in agriculture. In the July package the tiered approach was adopted. Paragraph 28 of the July framework agreement states that tariff reductions will be made through a tiered formula. In other words, all the tariff rates will be divided into different tiers or bands and then tariffs would be reduced within each band.

This approach intends to achieve harmonisation by cutting the higher tariff tiers or bands, or the tariff rates that are in the higher tariff brackets, more than the lower tariff rates. However, the issues of number of bands, the positioning of the thresholds, and the methodology to be adopted for tariff reduction within each band, were all left to future negotiations.

Paragraph 7 of the HK Declaration states that four bands have been adopted for structuring tariff cuts. However, what have not been agreed are the thresholds, the quantum of cuts, etc. There is almost a convergence on undertaking linear cuts within all the bands. A linear formula could be represented as:

$T1=T2 \times (1-\frac{A}{100})$, where T1 is the final tariff rate, T2 is the initial tariff rate and A is a coefficient.

It is interesting to note that in August 2005, G20 had proposed that the tariff rates of developed countries be divided into five bands and that of developing countries into four bands and then tariffs within each band be subjected to linear cuts (See Table 8). Developed countries have more bands because of high tariff dispersion.

TABLE 8

**G20 proposal on tariff reduction in agriculture (percentage)**

| Developed Countries | | Developing Countries | |
|---|---|---|---|
| Number of Bands - 4 | | Number of Bands - 4 | |
| Thresholds (in AVEs) | Linear Cuts | Thresholds (in AVEs) | Linear Cuts |
| 0< Band I ≤20 | 45 | 0 < Band I ≤ 30 | 25 |
| 20< Band II ≤ 50 | 55 | 30< Band II ≤ 80 | 30 |
| 50< Band III ≤ 75 | 65 | 80< Band III ≤ 130 | 35 |
| 75 < Band IV | 75 | 130 < Band IV | 40 |
| Tariff Cap – 100 percent | | Tariff Cap – 150 percent | |

Developing countries such as India have low tariff dispersion and hence lower number of bands. Higher tariff bands will then be subject to greater linear cuts in order to meet the target of high tariff reduction, as warranted by the Doha mandate and the July package. Further, the proposal stated that the tariff reduction by developing countries would be less than two-third of the reduction undertaken by developed countries. G20 has also submitted that the tariffs in developed and developing countries be capped at 100 and 150 percent respectively. However, it seems that the G20 later changed its position on having five bands for developed countries. Today, there is a consensus on having four bands both for developed and developing countries for undertaking tariff reduction. The latest proposal of the G20 is given in Table 8.

What needs to be negotiated is the range of bands and the cuts within each of the bands. While negotiating the tariff cuts, it is pertinent to point out the huge tariff escalation in developed countries (See Table 9). Developing countries face formidable tariff barriers in developed countries in the form of tariff escalation. For instance, in Japan, the bound tariff rate on raw sugar is 224 percent and this climbs to as high as 328 percent for refined sugar. Canada levies

TABLE 9

**Tariff escalation in agricultural commodities in select developed countries**

| Product | Primary/ Processing Level | Average Final Bound MFN Tariffs (simple averages at the 6-digit of the harmonised system) | | | |
|---|---|---|---|---|---|
| | | USA | EU | Japan | Canada |
| Cocoa | Beans | 0 | 0 | 0 | 0 |
| | Chocolate | 6.9 | 21.1 | 21.3 | 59.0 |
| Coffee | Green | 0 | 0 | 0 | 0 |
| | Roasted | 0 | 9.0 | 12.0 | 0.4 |
| Oranges | Fresh | 3.5 | 16.7 | 24.0 | 0 |
| | Juice | 11.0 | 34.9 | 31.0 | 1.0 |
| Pineapple | Fresh | 1.2 | 5.8 | 12.1 | 0 |
| | Juice | 4.1 | 11.6 | 24.3 | 0 |
| Hides & Skins | Raw | 0 | 0 | 0 | 0 |
| | Tanned | 3.0 | 5.4 | 23.5 | 6.3 |
| Sugar | Raw | 32.8 | 134.7 | 224.9 | 8.5 |
| | Refined | 42.5 | 161.1 | 328.1 | 107.0 |

*Source:* FAO Fact Sheets: Input for the WTO Ministerial Meeting in Cancun, http://www.fao.org/documents/show_cdr.asp?url_file=/docrep/005/y4852e/y4852e02.htm (visited on 25 June 2005)

9 percent on raw sugar and 107 percent on refined sugar. The respective bound tariff rates for raw and refined sugar in EU are 135 per cent and 161 percent respectively. The story is the same if one looks at the tariff rates on cocoa beans vis-à-vis chocolate or fresh orange vis-à-vis orange juice. The net effect of these differential tariffs on raw and processed commodities is that it is difficult for developing countries to move up the chain of value addition.[16]

Hence, the reduction rates in the tariff reduction formula for developed countries should be such that they are able to bring down the high tariff escalation in developed countries. There is a huge difference of opinion between developed and developing countries on what should be the tariff reduction rates for different bands. Taking a leaf out of Annex A of the HK Declaration, the following tariff cuts can be proposed for developed countries.

TABLE 10.1

**Proposed tariff cuts in developed countries (percentage)**

| Bands | Thresholds | Tariff Cuts |
|---|---|---|
| Band I | 0 < Band I ≤ 30 | 65 |
| Band II | 30 < Band II ≤ 60 | 75 |
| Band III | 60 < Band III ≤ 90 | 85 |
| Band IV | 90 < Band IV | 90 |

*Source:* Derived from Annex A of the HK Declaration

On the basis of the rates given above, tariff cuts can be developed for developing countries. The important point to remember is that for developing countries, by virtue of the special and differential treatment, the tariff cuts will not be more than 2/3rd of the tariff cuts for developed countries (See Table 10.2). The bands for developing countries will be different from the bands of developed countries.

What is given in Table 10.1 and 10.2 is just one case. There could be other cases. For instance, if developed countries agree to undertake steeper tariff cuts, then developing countries will also have to undergo deeper cuts than what are given in Table 10.2. Similarly, if developed countries undertake

TABLE 10.2

**Proposed tariff cuts in developing countries (percentage)**

| Bands | Thresholds | Tariff Cuts |
|---|---|---|
| Band I | 0 < Band I ≤ 30 | 42 |
| Band II | 30 < Band II ≤ 80 | 49 |
| Band III | 80 < Band II ≤ 130 | 56 |
| Band IV | 130 < Band IV | 59 |

*Source:* Derived from figures given in Table 10.1

milder cuts than what is given in Table 10.1, then, developing countries will also take less steep cuts. The principle of developing countries not cutting tariff rates by more than 2/3rd does not mean that developing countries have to necessarily undertake a tariff cut equal to 2/3rd of the cut undertaken by a developed country. It only means that the maximum tariff cut that a developing country will have to undertake should not be more than 2/3rd of the cut undertaken by developed country. It can certainly be less than 2/3rd. Therefore, even for figures given in Table 10.1; the corresponding figures for developing country will not be more than the figures given in Table 10.2. However, it can certainly be less.

We can understand the possible impact of the tiered approach by taking the case of India. Table 11 represents a simulation using the figures given in Table 10.2. The simulation in Table 11 represents that even with the figures given in Table 10.2, there can be steep reductions in the tariff rates of many agricultural commodities in India.

If we apply the rates proposed by G20, then the reduction in tariff rates will be less steep as compared to the reductions done by using the figures indicated in Annex A of the HK Declaration (See Table 12). From the perspective of developing countries that have a defensive interest in agricultural trade, the figures proposed by G20 are apposite.

## *Special Products and Special Safeguard Mechanism*

Many countries like India have always demanded that exceptions to market access be put in place

[16] Prabhash Ranjan and Robin Koshy, Business Standard, 23 July 2005

TABLE 11

## Simulation of the impact of the tiered approach of tariff reduction on 671 agricultural tariff lines of India at HS 6 digit level using figures given in Table 10.2

| Band | Initial Tariff Rate | No. of Tariff Lines | Final Tariff Rate | | | |
|---|---|---|---|---|---|---|
| | | | A=42 | A=49 | A=56 | A=59 |
| 0 < Band I ≤ 30 | 0 | 11 | 0 | | | |
| | 10 | 10 | 5.8 | | | |
| | 15 | 1 | 8.7 | | | |
| | 17.5 | 1 | 10.1 | | | |
| | 25 | 14 | 14.5 | | | |
| | 30 | 2 | 17.4 | | | |
| 30 < Band II ≤ 80 | 35 | 12 | | 17.85 | | |
| | 40 | 13 | | 20.4 | | |
| | 45 | 7 | | 26.5 | | |
| | 55 | 25 | | 28 | | |
| | 60 | 1 | | 30.6 | | |
| | 75 | 1 | | 38.25 | | |
| | 80 | 1 | | 47.2 | | |
| >80<Band III ≤ 130 | 85 | 10 | | | 37.4 | |
| | 100 | 313 | | | 44 | |
| >130 Band IV | 150 | 223 | | | | 61.5 |
| | 300 | 26 | | | | 123 |
| | | Total 671 | | | | |

*Note:* The formula used for this table is as given below:

$T1=T2 \times (1-\frac{A}{100})$, where T1 is the final tariff rate, T2 is the initial tariff rate and A is a coefficient.

*Source:* Author's calculations

TABLE 12

## Simulation of the impact of the tiered approach of tariff reduction on 671 agricultural tariff Lines of India at HS 6 digit level using figures proposed by G20 given in Table 8

| Band | Initial Tariff Rate | No. of Tariff Lines | Final Tariff Rate | | | |
|---|---|---|---|---|---|---|
| | | | A=25 | A=30 | A=35 | A=40 |
| 0 < Band I ≤ 30 | 0 | 11 | 0 | | | |
| | 10 | 10 | 7.5 | | | |
| | 15 | 1 | 11.25 | | | |
| | 17.5 | 1 | 13.1 | | | |
| | 25 | 14 | 18.7 | | | |
| | 30 | 2 | 22.5 | | | |
| 30 < Band II ≤ 80 | 35 | 12 | | 24.5 | | |
| | 40 | 13 | | 28 | | |
| | 45 | 7 | | 31.5 | | |
| | 55 | 25 | | 38.5 | | |
| | 60 | 1 | | 42 | | |
| | 75 | 1 | | 52.5 | | |
| | 80 | 1 | | 56 | | |
| >80<Band III ≤ 130 | 85 | 10 | | | 55.2 | |
| | 100 | 313 | | | 65 | |
| >130 Band IV | 150 | 223 | | | | 90 |
| | 300 | 26 | | | | 180 |
| | | Total 671 | | | | |

*Note:* The formula used for this table is as given below:

$T1=T2 \times (1-\frac{A}{100})$, where T1 is the final tariff rate, T2 is the initial tariff rate and A is a coefficient.

*Source:* Author's calculations

**The first draft declaration released on 17 December 2005 had a bracketed date of 2010 for the elimination of export subsidies.**

before negotiating on the exact structure of the tariff reduction formula. The idea is to first protect the sensitivities attached to their agriculture sector before undertaking tariff reduction commitments. As a saving grace for developing countries such as India, the ministerial conference witnessed some forward movement in allowing developing countries to have an escape clause while fulfilling market access commitments. This escape clause exists in two forms – as special products and as special safeguard mechanism.

Under special products, the HK Declaration states that developing countries will have the flexibility not to subject an appropriate number of products to tariff reduction commitments. These products will be chosen on the basis of criteria such as livelihood and food security and rural development and more importantly the selection of these products will be made by the countries on their own. It is hoped that the window of self-designation will give the required flexibility to developing countries. However, the moot issue relates to the ambiguity over the term 'appropriate number'. The first draft, without specifying the number, did talk of having an upper limit while designating products as special products. It said that developing countries would have the flexibility to designate upto x (unknown value to be finalised) percent of their tariff lines as special products. It was hoped that countries would be able to agree to a specific number to replace x in the declaration. G33 suggested that developing countries should have the flexibility to keep 20 percent of their products outside the ambit of reduction commitments. However, this was not acceptable to developed countries and no agreement could be reached. Hence, the final declaration did not specify any number as 'appropriate number' and a final decision has been conveniently pushed to Geneva.

The declaration also talks of developing countries having recourse to special safeguard mechanisms towards protection from cheap imports. In other words, when there is a surge in flow of imports either due to depressing prices or due to increased volumes, developing countries will have a right to restrict these imports either by imposing additional duties or restricting the quantity.

### 2.3 Export Subsidies[17]

One of the so-called 'tall deliverables' of the HK Ministerial was an end date for agricultural export subsidies. The developed countries have agreed to eliminate all export subsidies on agriculture by 2013. However, before we start celebrating the decision, it is important to understand the political and economic nuances of the agreement. When the ministerial started, the EU was not willing to agree to any end date for elimination of export subsidies.

It was agreed by most analysts that an end-date to export subsidies was perhaps the least controversial 'quick-win', which HK should have started with, while building further on it to reinstate faith of developing countries in the Doha Round. However, with the EU keeping its cards close to its chest throughout the entire negotiations, attempts were made to drive a hard bargain.

The first draft declaration released on 17 December 2005 had a bracketed date of 2010 for the elimination of export subsidies. Anything written within brackets means it is still to be negotiated and is not final. The brackets were not acceptable to the G20. Brazil said that if the countries could not even agree to an end date, then, perhaps they were all wasting their time by coming to HK. It was only in the final hours of the ministerial, that the G20 and other countries were successful in convincing the EU to agree to remove the brackets but at the cost of writing 2013 instead of 2010 as

[17] This section draws from the Author's work, 'Doha Round: Hope Alive But Only Just', 2 (1) Trading Up, Centre for Trade and Development (2006)

the end date! The end date of 2013 does not mean much for a variety of reasons.

Most developing countries led by agriculture exporting countries such as Brazil and Argentina wanted 2010 and not 2013 as the end date. The Brazilians accepted the end date of 2013 only reluctantly on the promise that elimination would be progressive and front-loaded. This promise in the second draft of 18 December 2005 was an advancement on the first draft. It was a clear attempt to cajole the G20, particularly Brazil and Argentina, as countries like India who had a predominantly defensive interest in agriculture, were not too concerned about the end date. Secondly, the EU was already committed to removing all its export subsidies by 2013 under its Common Agricultural Policy (CAP) reform programme. Thirdly, and most importantly, export subsidies constitute a minuscule proportion of the overall quantum of trade distorting subsidies in the developed countries. In the EU for instance, export subsidies constitute only about 3.6 percent of the overall farm support. Moreover, even this insignificant reduction will be spread over a period of seven years, and would barely impact the fundamental distortions in international trade in agriculture.

In effect, the point can scarcely be missed that in the unequal power play, which characterises the WTO, the rich countries inevitably get away with bargains which are in sync with their internal policy requirements and timelines, while developing countries get arm-twisted into tacit acceptance. The supreme irony however is that even the date of 2013 comes with a rider. Paragraph 6 of the HK Declaration states that the date for the elimination of export subsidies will only be confirmed upon the completion of the modalities. This means, effectively, that the end date of 2013 is not final. This rider has created a lot of confusion, as its exact meaning is not clear. At one level, it seems to suggest that once that modalities are established, the issue of end date for elimination of export subsidies may be opened up again. If this happens, then, even the minimal gain of having 2013 as the end date for elimination of export subsidies may get diluted. For cotton, developed countries will eliminate export subsidies in 2006 (See Box 3).

BOX 3

**The cotton tangle**

Cotton became the flashpoint in the multilateral trade negotiations between developed countries on the one hand and LDCs along with the developing countries on the other. A deal on cotton was one of the litmus tests to check the sincerity of developed countries about the development dimensions of the trade negotiations. At the end of the ministerial meeting there was a deal on cotton. The moot issue is how effective it was.

The deal has three components:

1. On export subsidies it states that developed countries will eliminate all forms of export subsidies in 2006 as against 2013 for the other crops.
2. On market access it states that developed countries will give duty-free quota-free access to cotton exports from LDCs.
3. On domestic support it states that trade-distorting domestic support for cotton should be reduced more ambitiously than under whatever general formula is agreed and that it should be implemented over a shorter period. However, all this has been stated within square brackets, which implies that it is not final and is open to negotiation.

In a recent submission four cotton-producing countries – Burkina Faso, Mali, Chad and Benin – proposed the following formula for reducing trade-distorting domestic subsidies in cotton.

Rc = Rg + [(100-Rg) x 100]/3 x Rg, where Rg is the AMS cut for agriculture in general, and Rc is the AMS cut for cotton.

This formula will ensure speedier cut for cotton. So, a 60 percent general cut will produce an 82.2 percent cut for cotton. The challenge is to make developed countries commit to quick and drastic cuts of the trade-distorting subsidy on cotton.

# 3. Non Agriculture Market Access

In NAMA, the biggest casualty was that HK saw the adoption and cementing of a text that was part of the framework agreement of July 2004. It is important to look at the history of the NAMA negotiations in order to understand the context of the present agreement on NAMA. Developing countries had vociferously opposed the NAMA portion of the Draft Cancun Ministerial text. The reason behind this opposition was that the draft text of Cancun talked of having a non-linear formula for tariff reduction, limited flexibilities and an unviable clause for the treatment of the unbound tariff lines. At Cancun, developing countries succeeded in blocking the draft text.

Developing countries expected that this draft text on NAMA would not come up again in the future negotiations. However, to their surprise, they saw the same text coming up in the negotiations at the General Council in July 2004. The first draft of the July Framework agreement that came up on 17 July 2004 had exactly the same NAMA text that developing countries had rejected at Cancun. Developing countries opposed this again and mainly due to the efforts of the African countries an additional paragraph was added to this controversial text. This was the first paragraph in Annex B of the July Framework agreement, which said that whatever was given below was not final. This paragraph gave a window to developing countries to introduce a few things such as having a linear formula for tariff reduction. However, developing countries did not use this window at all. In the build-up to the HK Ministerial, they negotiated as if this additional paragraph did not exist. In other words, there was a tacit acceptance of the text that they had once rejected. This tacit acceptance was institutionalised in HK by formally placing the Annex B of the July Framework agreement minus the first paragraph at the heart of the negotiations. So, that which was inconclusive and not final is now an inseparable part of the multilateral negotiations.

**For retention of policy space it is important for developing countries such as India to have enough 'water' in the tariff lines.**

Before analysing the ministerial declaration it is important to understand the major expectations or demand of developing countries in NAMA. Developing countries have been demanding that:

1. They should be able to retain the policy space to use industrial tariffs as effective tools to pursue relevant developmental goals.
2. Developed countries should eliminate or reduce tariff peaks and tariff escalation to give better market access to developed countries.

These two basic demands of developing countries are the touchstone, which are to be used to analyse the outcome on NAMA in the HK Declaration.

For retention of policy space it is important for developing countries such as India to have enough 'water' (difference between bound and applied) in the tariff lines. If there is enough or adequate 'water', then developing countries will have the flexibility to increase their applied tariff rates if the situation so demands. For instance, India has a bound tariff rate of 34.3 percent and an applied tariff rate of 27.7 percent. The existing 'water' gives India the flexibility to increase its tariff rate from 27.7 percent to 34.3 percent if the situation so demands. This flexibility is extremely important to pursue various developmental goals that a sovereign country may have. Hence, a tariff reduction formula should be such that it does not take away the 'water' in the tariff lines, at least not completely. This development-friendly demand of developing countries in the NAMA negotiations is in complete contrast to what developed countries have been arguing. Developed countries such as US have

argued that the tariff reduction formula should bring the existing bound tariffs below the existing applied tariff rates. This, according to them, will result in real and improved market access. This is a flawed argument, as the analysis later will reveal.

Another major developmental benchmark, which should be used to interpret the ministerial declaration, is the prospect of better market access for the products of developing countries. For better market access, especially for products of export interest to developing countries, it is necessary for developed countries to cut or eliminate their tariff rates. Hence, the tariff reduction formula should be such that cuts deep into the tariff rates of developed countries.

In NAMA, the following key decisions were taken at HK:

1. There will be a 'Swiss formula with coefficients' for cutting tariff rates.
2. The flexibilities to the tariff reduction formula will be a stand-alone provision.
3. Participation in sectorals will be on a non-mandatory basis.
4. A non-linear mark-up will be adopted for unbound tariff lines.

All these issues will be discussed separately.

## 3.1 Swiss Formula with Coefficients[18]

One of the few things that were agreed upon by countries in NAMA was the adoption of a 'Swiss formula with coefficients' for cutting industrial tariffs (Paragraph 14 of the HK Declaration). However, a 'Swiss formula with coefficients' has created a lot of confusion. Many have interpreted this as the acceptance of the dirty 'Swiss formula' that cuts industrial tariff rates steeply and in fact cuts higher tariff rates even more steeply. However, this is not true and part of the reason for this kind of interpretation doing rounds is that the literature on industrial tariffs in the WTO has often demarcated between a 'Swiss formula and a 'Swiss type or a modified Swiss formula'. Therefore, each time we see the words 'Swiss formula' it makes us think that the bad and ugly 'Swiss formula' is back again and now embedded in the multilateral trade negotiations.

At the conceptual level it is important to understand the distinction between a 'Swiss formula' and a 'modified Swiss formula', which is also a Swiss formula. Swiss formula is written as

$T1 = \frac{B \times T}{B + T}$, where T1 is the final tariff rate, T is the initial tariff rate and B is a coefficient.

A 'modified Swiss formula' could be written as

$T1 = \frac{(B \times X) \times T}{(B \times X) + T}$, where T1 is the final tariff rate, T is the initial tariff rate, B and X are coefficients. The difference between the 'modified Swiss formula' and the 'Swiss formula' is the presence of the additional coefficient X. It is important to understand that this coefficient is only an additional feature in the 'Swiss formula' mentioned above and has an impact on the existing coefficient B. So (B × X) is only a new coefficient that we have in the normally understood 'Swiss formula'. This new coefficient will be either greater than B or smaller than it depending on the value of X. So, if B × X = Y, then the so-called 'modified Swiss formula' will become a 'Swiss formula' and can be represented as:

$T1 = \frac{Y \times T}{Y + T}$, where Y is a coefficient and T1 and T are the final and initial tariff rates. So, we find that this so-called 'modified Swiss formula' is also essentially a 'Swiss formula'. The only difference is that the so-called 'modified Swiss formula' has one more factor (X in the example above) or coefficient embedded in the formula.

### *Possible Interpretations of Paragraph 14*

After this conceptual understanding, it is important to understand how the countries will negotiate towards establishing modalities for a

[18]This section draws from author's work that will be published in a forthcoming issue of Economic and Political Weekly (EPW).

tariff reduction formula. The adoption of a 'Swiss formula with coefficients' implies two things – a Swiss formula will be adopted and it will have more than one coefficient. Reading both these provisions together it implies that a Swiss formula, which has only one coefficient for both developed and developing countries, will not be adopted. The word 'coefficients' in Paragraph 14 means two things:

1. A Swiss formula, with two different coefficients, one each for developed and developing countries. Such a formula could be represented as

$T1 = \frac{B \times T}{B + T}$, where T1 is the final tariff rate, T is the initial tariff rate and B is a coefficient which has different values for developed and developing countries. B = m for developed countries, and B = n for developing countries.

This formula is a simple Swiss formula and is similar to one that has been proposed by countries like the US or even Pakistan. The difference in the proposal of US and Pakistan is the value of the coefficient for developed and developing countries.

2. A Swiss formula, with 2, 3, or *n* number of coefficients with these coefficients being embedded in the formula unlike the formula given above, which has more than one coefficient and hence is a 'Swiss formula with coefficients' but has only one coefficient embedded in the formula.

This kind of formula could be represented in many ways. Below are the two most important ways in which such a formula could be represented:

$T1 = \frac{(B \times X) \times T}{(B \times X) + T}$, where X is the average tariff rate of a country. This has been discussed above. This type of formula has been proposed by Argentina, Brazil and India.

Another manner in which this formula could be represented is as follows:

$T1 = \frac{\{(B + C) \times X\} \times T}{\{(B + C) \times X\} + T}$, where T1 is the final tariff rate, T is the initial tariff rate, B is a coefficient, X is the average tariff of a country and C is the credit to be accorded to a developing country.

The Caribbean group of countries has proposed this formula. The rationale for this formula is that countries use tariffs for numerous purposes such as generating revenue and therefore these factors should also be taken into account while cutting tariff rates.

One may argue that the formula that has been proposed by the Caribbean group of countries is not a Swiss formula within the mandate of the HK Declaration. This is not true. $\{(B+C)\} \times X\} \times T$ will also yield a single coefficient. Assuming that such a coefficient is K and replacing $\{(B+C)\} \times X\} \times T$ by K in the above formula we get:

$T1 = \frac{K \times T}{K + T}$, which is a Swiss formula.

The question that arises is which of these two interpretations shall be adopted. Developing countries such as Argentina, Brazil and India and other Caribbean countries have been arguing that the latter interpretation should be adopted.

Let us see how best the HK Declaration on reducing the industrial tariffs can be interpreted from the point of view of developing countries. Paragraph 14, apart from stating that a 'Swiss formula with coefficients' will be adopted, also states that the coefficients be adopted at levels which 'shall'

1. take fully into account the special needs of developing countries, including through less than full reciprocity (LTFR), in reduction commitments.
2. reduce tariff peaks and tariff escalation.

In other words, the declaration makes it binding and mandatory (as implied by the word 'shall') to have such coefficients in the formula that will eliminate tariff peaks and tariff escalation and also honour

LTFR. In this entire equation the interpretation of LTFR holds the key to the determination of the coefficients in the Swiss formula.

## *Less than full reciprocity (LTFR)*

The interpretation of LTFR has always been a moot issue. Different countries have attempted different interpretations to suit their interest. However, the most common and acceptable interpretation is that developing countries should undertake less stringent obligations than what developed countries will undertake.

This can be understood with the help of the following example. Imagine that the initial tariff rate of a tariff line 'A' is 10 percent in a developed country 'M' and the initial tariff rate of the same tariff line in a developing country 'N' is 50 percent. Now if 'M' agrees to reduce the tariff rate by 70 percent, then 'N' should reduce its tariff rate by any value that is less than 70 percent and not by 70 percent or more. So, in other words, honouring 'LTFR' in context of industrial tariffs implies that developing countries undertake lesser cuts than what developed countries will undertake. In this example let us assume that developing country 'N' cuts its tariff rate by 65 percent (See Table 13). The final tariff rate for this country will be 14.

However, this interpretation of LTFR is not complete as it is a mere technical fulfilment of LTFR. The other important part is that there should be a substantial gap between percentage reduction that developed and developing countries undertake. Only a substantial gap would ensure LTFR in real terms. This brings us to the question of what is a substantial gap to ensure real LTFR. In this regard it can be proposed that for real LTFR in industrial tariffs developing countries cannot be expected to undertake commitments, that would be more than two-thirds of commitments made by developed countries. Hence, for real LTFR a developing country should cut its tariff rate by 2/3rd of what a developed country is doing, or less. In this example, if a developed country cuts its tariff rate by 70 percent, then a developing

Table 13: **Demonstration of LTFR (percentage)**

| Country | Initial Tariff | Reduction in Initial Tariff | Final Tariff |
|---|---|---|---|
| M | 10 | 70 | 3 |
| N | 40 | 65 | 14 |

*Source*: Author's calculation

country should not cut its tariff rate by more than 46 percent (2/3rd of 70). It can cut by less than 46 percent. The reason why a difference of 2/3rd is being used to operationalise real LTFR in industrial tariffs is that the same gap has been proposed in agriculture.

However, the principle of real LTFR is not foolproof and may have its limitations, especially in cases where the tariff rates of developed countries are already very low. For instance, if the tariff rate in a developed country comes down from 4 percent to zero percent, there will be a reduction of 100 percent. This reduction in the tariff rate, however, will change the price only notionally from 104 units to 100 units (assuming 100 units is the base price). On the other hand, if a developing country has to cut its initial tariff of 30 percent by 2/3rd of 100, which is 66 percent, then the final tariff rate will be 10 percent and the price of the imported product will come down from 130 units to 110 units, which is a steep reduction in the price. In this case, although there is real LTFR, the developing country stands to lose out, as the product of the developed country will get cheaper in the market of the developing country whereas there will not be any significant change in the price of the product of the domestic country.

## *Implementing Paragraph 14*

What follows from the above discussion is that the coefficients in the Swiss formula should be such that LTFR in reduction commitments is really honoured. On the basis of this we will endeavour to find out the coefficients by taking the example of tariff rates of textile and clothing in the US and India. However, in order to honour LTFR (i.e. developing country cutting its tariff rates at lesser rate than a developed country), one needs to first

find out the rate at which developed countries should cut their tariff rate.

Paragraph 14 is a useful tool to find out the rate at which a developed country should cut its tariff rate. It states that coefficients in the Swiss formula 'shall' eliminate or reduce tariff peaks and tariff escalation. The bound tariff rate (BTR) of textile and clothing in the US is 8.6 percent, which is almost three times the average tariff rate of 3.2 percent for all non-agricultural products in the US. This is a clear case of tariff peaks. Hence, a tariff rate as high as 8.6 percent should come down to at least 3 percent, which means a reduction of 65 percent. For a reduction of 65 percent the coefficient in the first type of formula for the US will be 5.

Now, as per the interpretation of LTFR, India should certainly not cut its tariff rate by more than 2/3rd of 65 percent, which is 43 percent. India's BTR for textile and clothing is 26.3 percent.[19] After a reduction of 43 percent, this will come down to 14.2 percent. The coefficient for such a reduction will be 30 (See Table 14).

In this case the coefficients in the Swiss formula will be 5 for developed country and 30 for developing country. These values of coefficients are completely different from what developed countries have been proposing. For instance, the EU proposed that the value of the coefficient for both developed and developing countries should be the same. Same coefficient for developed and developing country implies violation of LTFR. Similarly, the US proposed that both the coefficients in the Swiss formula should be 'within the sight of each other'. In other words, the coefficients should not be too far away from each other. One of the fundamental reasons behind the US advocating that the coefficients should be 'within the sight of each other' is to make sure that bound tariff rates of countries like India come below the applied tariff rates. This attempt is not acceptable to India, as it would like to retain 'policy space' by having 'water' (difference between bound and applied tariff rate) in the tariff line.

Besides, this proposal will also not stand the scrutiny of the HK Declaration, as Paragraph 14 clearly states that the coefficients should be at levels that will ensure LTFR. However, if the coefficients are 'within the sight of each other', then LTFR will be violated and hence there will be a violation of Paragraph 14. From the above example, it is clear that for honouring real LTFR the two coefficients have to be at least six times apart from each other.

Even if we assume the mere technical fulfilment of the 'LTFR principle' and cut the BTR of textile and clothing in India by 50 percent, the coefficient for reduction will be 26, which is still five times more than the coefficient for a developed country (See Table 15). This drives home the point that

Table 14a: **Demonstration of the levels at which the coefficients should be to honour real LTFR (percentage)**

| Initial Tariff Rate (developed country) | Reduction | Final Tariff Rate (developed country) | Coefficient for Developed Country |
|---|---|---|---|
| 8.6 | 65 | 3 | 5 |

Table 14b: **Demonstration of the levels at which the coefficients should be to honour real LTFR (percentage)**

| Initial Tariff Rate (developing country) | Reduction | Final Tariff Rate (developing country) | Coefficient for Developing Country |
|---|---|---|---|
| 26.3 | 43 | 14.2 | 30 |

*Source*: Author's calculations

[19] World Trade Report 2004. The BTR for Textile and Clothing (T&C) in India is derived from the ad valorem bound rate of all the tariff lines in T&C and does not take into account the 271 tariff lines in T&C that have specific duties.

even for mere technical fulfillment of LTFR the US proposal of having both the coefficients 'within the sight of each other' cannot be accepted.

So, the advantage of Paragraph 14 is that it puts an end to both the US and the European Commission (EC) proposals of reducing tariff rates.

The other advantage of Paragraph 14 is that it helps developing countries to make a case for a formula where the coefficients are far away from each other so as to honour LTFR.

## *Two Approaches*

The levels of coefficients once again bring us to the two interpretations of the Swiss formula, as was discussed above. The issue is which of the two variants is to be used for structuring the coefficients.

### *Option 1*

The first option is to go for the formula with two coefficients, one for developed and the other for developing countries. In such a case the coefficient could be 5 for developed country and 30 for developing country.[20]

So, the formula will be $T1 = \frac{B \times T}{B + T}$, where B = 5 for the developed country and 30 for the developing country (See Table 14).

### *Limitation of Option 1*

However, this formula approach has two limitations. The first limitation is that even with a coefficient value of 30, there is a steep reduction in the tariff rate for a country like India. For instance, if we use 30 as the coefficient to cut the tariff rate of 35 percent, which is the BTR of majority of tariff lines in India, then the final tariff rate will become 16 percent. This is drastic reduction and will eat up the 'water' in the existing tariff lines and take away the policy space. One of the major demands of India has been that it wants a tariff reduction formula that does not completely take away the existing 'water' in the tariff lines.

The second limitation arises when the value of B is low, say, 2 or even less, in the above formula. If the value of B is lower, the rate of reduction of the tariff rate will be even steeper. In such a case the developed country's tariff rate will come down steeply and may cause a steep reduction in the tariff rate of developing countries as well. For instance, if the value of B is 2, then 8.6 percent (in the above example) will come down to 1.6 percent, which is a reduction of about 81 percent.

Now, if we apply the above-mentioned proposal of developing countries cutting their tariff rate by a maximum of 2/3rd of what developed countries do, then, India (in this example) will have to reduce its tariff rate by 54 percent (2/3rd of 81). This reduction will result in the new tariff rate being 12

Table 15a: **Demonstration of the levels at which the coefficients should be to honour technical LTFR (percentage)**

| Initial Tariff Rate (Tm) (developed country) | Reduction in Tm | Final Tariff Rate (developed country) | Coefficient for Developed Country (option 1) |
|---|---|---|---|
| 8.6 | 65 | 3 | 5 |

Table 15b: **Demonstration of the levels at which the coefficients should be to honour technical LTFR (percentage)**

| Initial Tariff Rate (Tn) (developing country) | Reduction in Tn | Final Tariff Rate (developing country) | Coefficient for Developing Country (option 1) |
|---|---|---|---|
| 26.3 | 50 | 13.1 | 26 |

*Source*: Author's calculations

[20] This comes close to the proposal made by Pakistan for having a Swiss formula ( $T1 = \frac{BxT}{B+T}$ ), where B = 6 for developed countries and 30 for developing countries.

percent, which is even less than the applied tariff rate of textile and clothing. If the final tariff rate is 12 percent, then the coefficient (B) in the formula will be 22.

It is interesting to note that although the coefficient for the developing country is 11 times more than the coefficient for the developed country, the tariff reduction is very steep. Technically, 2 and 22 are coefficients at levels that will honour real LTFR. However, in reality they will lead to steep reduction in the tariff rates of developing countries (India in this case). Hence, this formula option has its limitation and does not help the cause of developing countries.

### *Option 2*

The other option is to have the second kind of formula where the average tariff rate of a country is one of the coefficients in the formula. In this case the formula could be

$T1 = \frac{(B \times X) \times T}{(B \times X) + T}$, where B is a coefficient, X = Average tariff rate ( 34.3 percent in the case of India[21]) for developing countries.

The advantage of having the average tariff rate of a country in the Swiss formula is to ensure that there is no disproportionate tariff cut. Besides, the new tariff rate is reflective of the tariff structure of a particular country and is not independent of these integral factors. For instance, if we apply the second option to the example of BTR of textile and clothing of US and India we will get a clearer picture. If we use this option to cut the BTR of textile and clothing in US (T= 3.2), the new tariff rate (T1) will be 2.3 (X = 3.2 {Average tariff rate of US}, B = 1). This is a reduction of 73 percent. Now, if we apply the principle of 2/3rd for India, then India will cut its tariff rate by 48 percent, which will result in the final tariff rate being 13 percent. In the formula option one, with 13 as final tariff rate, the coefficient will be 26. However, this, as we have seen before, cannot be accepted, as it will lead to a very steep reduction.

Now, if we apply the formula option two to the facts at hand, the final tariff rate (T1) for India will be 15 percent (B = 1, X = 34.3 {Average tariff rate}). This may be acceptable. It is important to note here that if the value of B increases the reduction will be less.

The proposal to use average BTR of a country as the coefficient drew opposition from some developing countries whose average BTR was very low.[22] These countries have argued that if they use average BTR as the coefficient, then they will have to undertake reductions, which may be more than 2/3rd of the reduction of developed countries. This is a genuine difficulty. For such countries, a mark-up to the average BTR could be proposed. This mark-up could be at levels that will not make these countries undertake tariff reductions that are more than 2/3rd of the cuts of developed countries.

The above discussion reveals that both the formula options could be used, as they will honour real LTFR. However from the perspective of developing countries, the second option is better, as it can overcome the limitation of the first option. Moreover, having a country's average tariff rate as one of the coefficients in the formula (suggested by Argentina, Brazil and India) or having a formula that gives credit to countries apart from incorporating the average tariff rate (suggested by the Caribbean countries) allows taking into account the existing tariff structure of an individual country in the process of cutting the tariff rates. The presence of the average tariff rate as a coefficient will make sure that the new tariff rate is in consonance with the existing tariff structure of a country.

Hence, the above discussion clearly demonstrates that the mandate of Paragraph 14 of the HK

[21] The average BTR of India is derived from the ad valorem bound rates and does not take into account the specific duties on 271 tariff lines.

[22] The average BTR of non-agricultural goods in South Asian countries is very less. For instance in Malaysia the average BTR is 14.9 percent. Similarly, the average BTR in Thailand is 24.2 percent.

Declaration can only be met if we follow the second formula option for reducing tariff rates.

## 3.2 Flexibilities in NAMA

Flexibility in NAMA implies that some of the tariff lines would not be subject to the tariff reduction formula. This is important in order to protect some sensitive sectors. Developing countries expended their negotiating capital and energy on flexibilities, rather than on tariff reduction modalities. As was the case with agriculture, developing countries were keen to make sure that flexibilities or the escape clause provisions in NAMA were reiterated as a stand-alone provision. Paragraph 8 of Annex B states that the flexibility to developing countries in the NAMA negotiations will be available in either of the following two ways:

1. Applying less than formula cuts for up to 10 percent of the tariff lines
2. Not applying formula cuts for up to five percent of the tariff lines.

The Paragraph 8 flexibilities were supposed to be stand-alone provisions and not linked to tariff reduction formula. However, there were attempts by developed countries after the July agreement to link tariff reduction with flexibilities. The EU, in one of its proposals, argued that developing countries that used the flexibilities would have to cut their tariff rates at the same rate as developed countries and only those developing countries which did not use the flexibilities would get 'credits' that could be used to increase the coefficient for tariff reduction.

In other words, the EU proposed that countries that used the flexibilities should be penalised by asking them to cut their tariffs steeply. Such an erroneous and non-development-friendly proposal would have meant virtually rewriting the July Agreement. This was not acceptable to developing countries. The concern regarding the rewriting of an agreed text brought nine countries together to form a core group on NAMA in HK. This group was successful in getting a reaffirmation in the declaration regarding the importance of the flexibilities in the NAMA negotiations. Paragraph 15 of the HK Declaration reaffirms the importance of flexibilities given in Paragraph 8 of Annex B of the July Framework. This reaffirmation proves that flexibilities are a stand-alone provision unlike the proposal of some of the developed countries such as the EU.

However, the issue of flexibilities reveals the crevices in the entire process of multilateral negotiations. The fact that flexibilities in NAMA are stand-alone provisions had been agreed upon in July 2004. It was expected that negotiations would focus their attention beyond what had already been agreed to. Instead of negotiating for the future, developing countries had to spend their precious negotiating capital and energy on saving something that had already been agreed.

## 3.3 Sectorals

The issue of sectorals has always been a contentious issue in NAMA negotiations. Developed countries have argued for a sectoral initiative. Under a sectoral initiative, countries undertake negotiations for eliminating tariff rates for certain sectors independently of the tariff-cutting formula that will be followed for the sectors outside the sectoral initiative.

Many developing countries have argued that the issue of sectorals should be taken up only after the issue of tariff reduction formula is settled. In fact, this has been the position of India. Some commentators have argued that, for countries like India, the issue of sectorals is a sequencing problem – these countries intend to take this up only after settling the tariff reduction modality, and are not opposed to it *per se*.

Be that as it may, the HK Declaration states that participation in sectorals will not be mandatory for countries. However, the issue for many developing countries including India is what happens once the

**Flexibility in NAMA implies that some of the tariff lines would not be subject to the tariff reduction formula which is important to protect some sensitive sectors.**

tariff reduction modality is agreed upon. Will India participate in the sectorals? Developed countries may put pressure on countries to participate in the sectoral negotiations.

## 3.4 Treatment of Unbound Tariffs

There are many developing countries that do not have a bound tariff rate for many of their tariff lines.[23] This has been considered necessary because of the sensitivity attached with many of these tariff lines. Given the sensitive nature of these products, countries did not want to have an upper limit of levying a tariff duty (bound tariff rate). It has been argued and rightly so that for certain commodities, countries should have complete policy space and flexibility to increase the tariff rates to any limit if the situation so demands. However, in the present round of negotiations, this is to change and all countries have to convert their unbound tariff lines to bound lines.

The treatment of unbound tariff lines has two major issues.

1. How to bind the unbound tariff lines
2. How much to bind.

Different countries have proposed different approaches for the treatment of unbound tariff lines. Before the HK Ministerial there were mainly four approaches on the negotiating table for binding unbound tariff lines:

1. Multiplying the MFN applied rate of 2001 by two (July Framework).
2. Capping of new bound tariffs at a ceiling of 40 percent with an average of 25 percent and no tariff reductions in this round for new tariff bindings.
3. Non-linear mark-up. Adding 5 percentage points (absolute) to each unbound rate.
4. Marking-up unbound lines by *x* times (to be negotiated) and binding tariff lines at an average level after the application of the formula.

Paragraph 17 of the HK Declaration talks of adopting a non-linear mark-up approach to establish base rates for the presently unbound tariff lines. This clearly implies that the options of linear marking-up the unbound tariff lines by *x* times the average applied rate or by x times the average bound rate is no more relevant.

However, what is yet to be decided is the quantum of non-linear mark-up. Here again two approaches could be followed:

1. A constant number of percentage points to be added to the applied rate in order to establish the bound rate.
2. Different number of percentage points to be added depending on the level of applied rate. This will imply that if the present unbound applied rate is less then a higher percentage point could be added or if the level of the present unbound applied rate is high then a lower percentage point could be added.

In deciding the quantum of non-linear mark-up it is important to keep in mind the sensitivity of the tariff lines involved. Hence, the tariff lines should not have marked-up base rates that are fractionally more than their present applied rates. One proposal on the quantum is to have a non-linear mark-up by 5 percent. So, if the applied tariff rate of an unbound tariff line is say, 25 percent, the marked-up bound rate of this tariff line will now be 30 percent. This is an insignificant increase. It completely erodes the policy space available to the country. Earlier, this country could apply any tariff rate that it thought was necessary because of the sensitivity attached to the product and now it cannot impose a tariff in excess of 30 percent. Hence, the quantum of non-linear mark-up should be substantial. In this regard, the proposal made by Pakistan is relevant. The Pakistani proposal states that there should be a non-linear mark-up of 30 percent.

[23] The tariff lines that do not have a bound tariff rate are called unbound tariff lines.

Even a 30 percent non-linear mark-up may not be appropriate for all countries and all tariff lines. It is important to understand that applied tariff rates are not good indicators or reference points. Countries change their applied tariff rates as per the needs of the situation. For instance, there may be a very sensitive product whose applied tariff rate is low because, in spite of its sensitivity, the imports of that particular product are down because of say, drop in global production of that commodity. In this case if this applied tariff rate is used as the reference price for marking-up, the new marked-up bound tariff rate may not reflect the actual sensitivity of this product. Hence, it is necessary for developing countries to negotiate for a higher marked-up bound tariff rate.

In this regard it is suggested that a non-linear mark-up with different percentage points for different tariff lines should be adopted. Hence, the tariff lines that have lower applied rates should be bound at higher rates by adding greater percentage points.

This higher marked-up bound tariff rate is also important and necessary because Paragraph 17 of the HK Declaration also states that the marked-up bound tariff rates will be subject to tariff reductions. Hence, if the quantum of mark-up is low, then the marked-up bound tariff will also be only marginally higher than the applied tariff, and if this is subject to tariff reduction formula, then it may result in the final bound rate being even lesser than the initial applied tariff rate.

For instance, assume that the initial tariff rate of an unbound tariff line is 30 percent. If we have a 5 percent mark-up, then the marked-up bound tariff rate will become 35 percent. Now, if this marked-up bound tariff rate of 35 percent is subject to a simple Swiss formula where the value of the coefficient is 30[24], then the final tariff rate

BOX 4:

**Case study of unbound tariff lines: Passenger cars in India[25]**

Passenger cars in India are unbound and enjoy an applied rate of 100 percent. Now if this applied rate of 100 percent is bound by using a mark-up of 5 percent, then the newly bound tariff rate for passenger cars in India will be 105 percent. Now, if this newly bound tariff rate of 105 percent is subjected to a tariff reduction by using option 1 of the tariff reduction formula (coefficient 30) that has been discussed earlier in the paper, then the new bound tariff rate will be 23.33 percent. This is a reduction of colossal 77 percent from the original applied rate. If the same applied rate is marked-up by 30 percentage points and then subjected to tariff reduction (option 1, coefficient 30) the new bound tariff rate will come down to 24.37 percent. This is also a reduction of almost 76 percent, marginally less than when the mark-up is 5 percent. This illustrates the point that if there is a higher mark-up then, there will be lesser reduction even with the same formula.

However, if we apply the ABI formula (B = 1, Average BTR 34.3 percent) to the two mark-ups of 5 and 30 percent to the applied tariff rates of passenger cars in India, we will get a completely different picture. With a mark-up of 5 percentage points, the new bound tariff rate will be 25.8 percent. With a mark-up of 30 percentage points, the new bound tariff rate will be 27.1 percent.

This clearly shows that with an increased mark-up and then applying the ABI formula will lead to less reduction as compared to other options.

[24] Simple Swiss formula $T1=\frac{B \times T}{B+T}$, where T1 is the final tariff rate (16 percent), B is 30 and T is the marked-up bound tariff rate (35 percent).

[25] This section has been developed from the presentation made by Mr. Jehangir Engineer in the National Consultation, 'WTO and India: Strategising Beyond Hong Kong' organised by Centad and FICCI on 20 March 2006 in New Delhi.

will be 16 percent, which is much less than the initial applied tariff rate of 30 percent. So, for a sensitive product, the new bound tariff rate, after applying the mark-up approach and the then tariff reduction, results in increasing the vulnerability for the concerned country. In this regard the case study of passenger cars in India is interesting[26] (See Box 4). The example of passenger cars is used to show what could be the possible scenarios of non-linear mark-up and subsequent application of the tariff reduction formula.

The other issue in the treatment of unbound tariff lines is whether the same tariff reduction formula should be used for reducing the marked-up bound tariff rate or whether there should be a different approach. It has been argued that it is implicit in the mandate to have the same formula for marked-up bound tariff rate. However, given the sensitivity attached with the unbound tariff lines, they should be cut by using a milder formula, or at least with a Swiss formula that has a higher coefficient than what will be used by developing countries for cutting their already bound tariff lines.

The other two important recommendations for the treatment of unbound tariff lines are:

1. To have a 'cool-off' period before marked-up bound tariff rates are subjected to tariff reductions. For instance, if the applied tariff rate of an unbound line is 50 percent and it has been marked-up by 20 percentage points, then this new marked-up bound rate of 70 percent should remain for at least 5 years before it is subjected to reduction. This 5-year period is the 'cool-off' period.
2. The tariff reduction of the marked-up bound tariff rate should be spread over 10 years and should be back-loaded. So, if the marked-up bound tariff rate of 70 percent is to be reduced to 40 percent, then this reduction of 30 percentage points should be spread over 10 years.

# 4. Balance between Agriculture and NAMA

One of the most interesting outcomes of the HK Declaration was the formal linking of agriculture and NAMA. It is common knowledge that trade negotiations involve across-the-board give and take. So, if a country is giving something in agriculture, it will try to extract its pound of flesh in some other area such as NAMA or services. Many have argued against the merits and demerits of such an approach.

In HK, Paragraph 24 institutionalised this linkage. Paragraph 24 states that:

1. It is important to advance the development objectives of the round through enhanced market access for developing countries in both agriculture and NAMA.
2. There should be comparable high level of ambition in market access for agriculture and NAMA.
3. This ambition is to be achieved in a balanced and proportionate manner consistent with the principle of special and differential treatment.

This is a strange paragraph and perhaps difficult to interpret. In fact, it can be subjected to multiple interpretations. One important interpretation could be that if a particular rate is identified as the basis of undertaking cuts in one area, say agriculture, then, the cuts in NAMA will be directly proportional to the cut that has been agreed for agriculture. So, if developed countries propose to cut their tariff rates by 40 percent, then it automatically means that tariff cuts in

[26] Some may argue that passenger cars are not a sensitive product and therefore may not capture the debate on unbound tariff lines comprehensively. However, the issue here is not to advocate that passenger cars are sensitive products. The purpose is to demonstrate how the declaration on unbound tariff lines in Hong Kong could lead to steep reduction in the presently unbound tariff lines.

NAMA will also be in the region of 40 percent. If the cuts in NAMA are more than what have been proposed in agriculture, it will not lead to a balanced and proportionate outcome and hence it will be a violation of Paragraph 24.

So, if the EU argues that there should be steep reduction in tariffs of industrial products, then it should offer steep reduction in agricultural tariffs as well as per the requirement of Paragraph 24. But, if the EU proposes a tariff cut of only 39 percent for agricultural tariff lines, then it cannot ask for an ambitious and steep cut in NAMA.

Paragraph 24 is significant for developing countries in many ways. If the EU proposes an average tariff cut of 39 percent in agriculture, then the average tariff cut in NAMA will also be in the same region. Assuming that the average tariff cut in NAMA by developed country is also 39 percent, then a developing country will reduce tariffs by not more than 26 percent (2/3rd of 39 percent). On the other hand, if the EU proposes to cut its average tariff rate in agriculture by 60 percent (which is unlikely), then, the same reduction will be undertaken in NAMA. This implies that the developing country will undertake reduction by not more than 40 percent (2/3rd of 60 percent).

Hence, how Paragraph 24 will be interpreted ultimately is not clear and therefore what significance it has for developing countries is also something that cannot be clearly established.

# 5. Conclusion

HK was a failed opportunity to correct the rigged nature of global trade. At the most, it was a small step forward on the long and winding road towards correcting the rigged and imbalanced character of global trade. With gruelling deadlines and a spate of post-HK meetings happening, it is very important for developing countries not to lower their guard. The process of engagement has to continue in a very proactive manner. Keeping in mind the HK Declaration this paper has tried to highlight the following points with regard to the future negotiations:

**Agriculture**

- Developing countries should ask for a very steep reduction in the bound levels of the OTDS so as to bring the new bound levels at levels that are substantially lower than their present applied levels. This is the only way to ensure 'effective cuts' as mandated in the HK Declaration.
- The elimination of trade-distorting domestic support should be front-loaded with 2010 as the end-date for elimination.
- There is a need for an effective tightening of green box subsidies with very clear provisions on de-coupled income support and direct payments.
- Developed countries should undertake steep reduction in their present agricultural tariff rates so as to tackle the problem of tariff escalation.
- Developing countries should not be asked to undertake cuts that are more than 2/3rd of the cuts that developed countries will undertake.

**NAMA**

- The ABI proposal for tariff reduction should be adopted, as it is the only way to fulfill the mandate of Paragraph 14 of the HK Declaration.
- Developing countries should be allowed to retain their policy space while undertaking tariff reductions by allowing them to have 'water' between their applied and bound tariff rates.
- LTFR should be honoured completely, and in a real sense, by not asking developing countries to undertake tariff cuts that are more than 2/3rd of the tariff cuts undertaken by developed countries.

- Flexibilities in NAMA should be a stand-alone provision and should in no way be linked to the tariff reduction formula.
- The quantum of the non-linear mark-up for unbound tariff lines should be substantial.
- The reduction of the marked-up bound tariff rate should be such that there continues to be 'water' in the new bound tariff rate and applied rate that was used for marking-up.
- The tariff reduction formula for reducing the marked-up tariff rate should use a higher coefficient than what will be used by developing countries for reducing the already bound tariff rates.

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