Knowledge Sharing Program

# WTO Accession Strategies for Azerbaijan

September 2008

MINISTRY OF STRATEGY AND FINANCE

KDI Korea Development Institute

WTO Accession Strategies for Azerbaijan

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# WTO Accession Strategies for Azerbaijan

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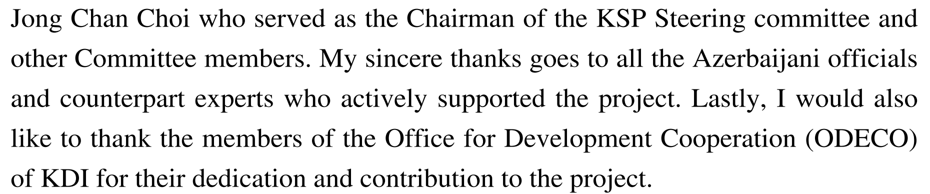
Korea Development Institute

# Preface

In the 21st century, knowledge is the key factor in determining a country's level of socio-economic development. From this recognition, the Knowledge Sharing Program (KSP) was launched in 2004 by the Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI). KSP is designed to contribute to the socio-economic development of the targeted development partnership country by sharing Korea's development experiences. The most distinguishing characteristic of KSP is that it is demand-driven and participation-oriented. The program analyzes the problems from the partnership country's perspective and provides policy implications that are not far-reaching but can be practically implemented in the environment of the partnership country. For Azerbaijan, the Knowledge Sharing Program was initially launched when the Azerbaijani Government showed deep interest in the Program, when former President Roh Moo-hyun visited Azerbaijan in May 2006.

Through an extensive survey of the Azerbaijani Government and agencies, KDI and the Ministry of Economic Development of the Republic of Azerbaijan, the counterpart organization, decided to tackle the issue of WTO accession by Azerbaijan. After careful and intensive consultations, four sub topics were identified which are presented in this report. The sub topics include sectoral issues in services negotiations, analysis of developing country status in the WTO system, how to introduce and establish a WTO-consistent trade remedy system and strategies for industrial diversification through export promotion.

I would like to take this opportunity to express my gratitude to the project manager Dr. Keukje Sung and all the project consultants including Dr. Dukgeun Ahn, Dr. Jaemin Lee and Dr. Siwook Lee for all their hard work in successfully completing the KSP for Azerbaijan. I would also like to thank former Minister



Jong Chan Choi who served as the Chairman of the KSP Steering committee and other Committee members. My sincere thanks goes to all the Azerbaijani officials and counterpart experts who actively supported the project. Lastly, I would also like to thank the members of the Office for Development Cooperation (ODECO) of KDI for their dedication and contribution to the project.

Upon this occasion of publishing the results of the KSP for Azerbaijan, I have a strong belief that the program results will be of great value for both Korea and Azerbaijan and I sincerely hope that through this Knowledge Sharing Program the Azerbaijani Government and relevant line ministry personnel could benefit from the Korean experience. I also hope our final report which sets out WTO Accession Strategies from various perspectives could be used as a catalyst in bringing the Azerbaijani economy one-step closer to the world market. The policy recommendations in this report, however, are based on the Korean experiences and are solely the opinions and recommendations of the authors.

Jung Taik Hyun
President
Korea Development Institute

# Contents

Introduction ........ 13

Chapter 01

Sectoral Issues in Services Negotiation of Azerbaijan for WTO Accession ........ 19

1. Assessment of Azerbaijan Commitments ........ 20
1.1. Background of Accession Negotiation ........ 20
1.2. Comparison with Incumbent Members ........ 20
2. Some General Issues in GATS ........ 28
2.1. Incidental Services ........ 28
2.2. Domestic Regulation and Regulatory Reform ........ 36
3. Sectoral Issues ........ 43
3.1. Telecommunications ........ 43
3.2. Distribution ........ 45
3.3. Audio-Visual ........ 46
3.4. Energy ........ 47
4. Summary and Conclusion ........ 48
Annex ........ 50

Chapter 02

Analysis of Developing Country Status in the WTO System:
Implication from the Korean Experience ........ 57

1. "Developing Country" in the WTO System ........ 58
1.1. Overall Structures of Special and Differential Treatment for Developing Countries ........ 58
1.2. Provisions Aimed at Increasing the Trade Opportunities of Developing Country Members ........ 63
1.3. Monitoring Mechanism/Processes on Special and Differential Treatment ........ 75

1.4. Determination of Developing Country” in the GATT/WTO ···················· 82
1.5. “Developing Country” in the Accession Negotiation ······················· 84
2. “Developing Country” Status for Korea ··································· 88
2.1. Korea in the GATT System ·········································· 88
2.2. Korea during the Uruguay Round Negotiation ························· 92
2.3. Korea in the WTO System ·········································· 100
3. Policy Recommendation for Accession Negotiation ························ 101
3.1. Strategies for “Developing Country” Status in Accession Negotiation ······· 101
3.2. Implication for the Status of Azerbaijan in the WTO System ················ 104
Appendix ······························································ 106

## Chapter 03

## Comment and Advice for Trade Remedy Legislations and Policies: Based on Korea’s Experience ··· 123

1. Introduction: Devising a Mechanism to Protect the Domestic Market Legitimately in the WTO ··············································· 124
2. Basic Guidelines for the Adoption of Trade Remedy Measures ················ 126
2.1. Maintain Consistency with WTO Agreements ··························· 126
2.2. Maintain Discretion of the IA ········································ 127
2.3. Focus on Procedural Aspect ········································ 130
2.4. Consider DDA Negotiations ········································ 132
2.5. Consider Feasibility in Actual Application ····························· 132
3. Suggestion for Specific Projects to be Implemented ························ 133
3.1. Finalizing Legislative Preparation ··································· 134
3.2. Creating IA ······················································· 139
3.3. Aligning Investigations and Reviews ································· 144
3.4. Restructuring Judicial Review Mechanism ···························· 145
3.5. Conducting Feasibility Test ········································· 146

# Contents

3.6. Active Participation in the WTO Dispute Settlement Procedure ............. 147
3.7. Review of Existing Measures ............. 150
4. Korea's Experience ............. 150
4.1. Legislative Work ............. 150
4.2. Investigating Authority ............. 151
4.3. Judicial Review ............. 155
4.4. Participation in the WTO Dispute Settlement Procedure ............. 156
4.5. Specific Issues in Antidumping Investigations ............. 157
5. Other Potentially Critical Issues ............. 166
5.1. Non-Market Economy ............. 167
5.2. Privatization ............. 170
5.3. Keeping Pace with Other CIS Countries ............. 172
5.4. Eliminating the Appearance of Bias ............. 173
5.5. Zeroing ............. 173
5.6. Using the IAs to Defend Azerbaijani Companies from Dubious Investigations . 174
6. Conclusion ............. 175

Chapter 04
The Strategies for Industrial Diversification through Export Promotion ............. 179

1. Introduction ............. 180
1.1. Growing Concerns over Industrial Structure of Azerbaijan ............. 180
1.2. Why is Industrial Diversification Important? ............. 183
1.3. How to Achieve Industrial Diversification? ............. 185
1.4. In which Aspects could the Korean Experience be Useful? ............. 186
2. Diagnostics for Export Structure of Azerbaijan ............. 187
2.1. Export Composition of Azerbaijan ............. 187
2.2. Sectors of Comparative Advantage ............. 190
2.3. Obstacles of Export Promotion ............. 194
2.4. Implications: Some Guidance for Export Promotion ............. 195
2.5. Recent Trend of Foreign Direct Investment into Azerbaijan ............. 196

3. Exports Based Industrial Diversification: Lessons from Korea ..... 198
3.1. Understanding the Initial Conditions ..... 199
3.2. Policies during the Miracle Years (1960-1973) ..... 200
3.3. Heavy and Chemical Industry Drive (1973-1980) ..... 203
3.4. Key Factors for the Korean Miracle: Institutions ..... 205
4. Industrial Policies under the WTO Era ..... 207
4.1. Trade Policy under the WTO era ..... 208
4.2. FDI Policy under the WTO Era ..... 210
5. Policy Suggestions ..... 212
5.1. Guidelines for Export Promotion ..... 212
5.2. Guidelines for FDI Policies ..... 213
6. Concluding Remarks ..... 215
Appendix ..... 217

## Contents | List of Tables


<Table 1-1> Overall Level of Commitments 22

<Table 1-2> Commitments by Income Level 23

<Table 1-3> Commitments by Region 24

<Table 1-4> Sector Coverage 25

<Table 1-5> Mode 3 Commitments 27

<Table 1-6> Offers in Incidental Services during UR 33

<Table 1-7> Offers in Incidental Services during the DDA 34

<Table 1-8> Level of Offers in Communication Services 45

<Table 1-9> Level of Offers in Distribution Services 46

<Table 2-1 > Written Proposals by Korea in the Uruguay Round 96

<Table 2-2> Article XIII Invocation for WTO Accession 103

<Table 4-1> Export Composition by Type of Goods 188

<Table 4-2> Top 5 Trading Partners 188

<Table 4-3> Top 10 Exporting Products of Azerbaijan 189

<Table 4-4> Inward FDI Performance 197

<Table 4-5> FDI Inflows by Industry 197

<Table 4-6> Characteristics of Industrial Policies for Selected East Asian Countries 198

<Table 4-7> Historical Context: Korea vs. Azerbaijan 199

<Table 4-8> The Changes in Top 10 Exporting Products 203

<Table 4-9> Three Categories of FDI Policy Measures 211

# List of Figures


<Figure 1-1> Level of Commitments ........ 22
<Figure 1-2> Sector Coverage ........ 25
<Figure 1-3> Comparison of 55 and 154 Sectors ........ 26
<Figure 1-4> Mode 3 Commitments ........ 27
<Figure 4-1> Recent Trend of GDP Growth Rates ........ 180
<Figure 4-2> Recent Trend of Inflation and Exchange Rates ........ 181
<Figure 4-3> Forecasts of GDP Growth Rate ........ 182
<Figure 4-4 > The Importance of Energy Sector ........ 182
<Figure 4-5> Industrial Output Growth vs. Employment Share ........ 183
<Figure 4-6> Recent Trend of Exports and Imports ........ 187
<Figure 4-7> CCIS for selected Countries ........ 192
<Figure 4-8> CCIS for selected Countries ........ 193
<Figure 4-9> FDI Inflows ........ 196
<Figure 4-10> The Trends of Exports and Imports ........ 202
<Figure 4-11> FDI and Human Capital ........ 214

# Introduction

Since 2004, Korean Ministry of Strategy and Finance (MOSF) has conducted the Knowledge Sharing Program (KSP) projects for selected developing countries. Until the end of 2007, nine such projects have been carried out. The purpose of KSP is to perform demand-driven and performance-oriented comprehensive consultations, by sharing specific knowledge and experience during the rapid Korean economic development. The projects are administered by the Office for Development Cooperation (ODECO) at Korea Development Institute (KDI).

MOSF and ODECO launched the KSP for Azerbaijan in October 2007 with the first visit by a group of consultants in order to explore the demand for the project from the Azerbaijan's perspective. After intensive consultations, 5 topics were identified, and among those 5, consultation on the WTO accession by Azerbaijan was chosen. A new group of Korean consultants, headed by Professor Keuk-Je Sung, as the project manager was formed. The topic has been further refined into the following four specific policy areas after the second visit and discussions in Azerbaijan during 15th to 21st of February in 2008.

- First, sectoral issues in services negotiation (*Consultant: Keuk-Je Sung, Kyung Hee University*);
- Second, analysis of developing country status in the WTO system: implication from the Korean experience (*Consultant: Duk-Geun Ahn, Seoul National University*);
- Third, how to introduce and establish a WTO-consistent trade remedy system (*Consultant: Jae-Min Lee, Hanyang University*);
- Fourth, the strategies for industrial diversification through export promotion (*Consultant: Si-Wook Lee, Korea Development Institute*)

During the year of 2008, the Korean KSP team organized the Pilot Study, Interim Reporting

Workshop and Final Reporting Workshop. The Pilot Study was conducted during 15th to 21st of February 2008 in Azerbaijan, and rather extensive and intensive general discussions were held for the topics and directions of consultations with the Ministry of Economic Development and 13 other Azerbaijan ministries and offices. During 5th through 10th of April, the Korean KSP team visited Azerbaijan for the Interim Report. From the Azerbaijani side, there were 19 participants including Mr. Mikayil Jabbarov, Vice Minister of Economic Development. Intensive discussions with the Ministry of Foreign Affairs and Ministry of Communication and IT were also held.

In May 21st through 27th, Final Reporting and Policy Practitioners Workshop were held in Seoul, inviting the Azerbaijan delegation to Seoul. During this period, not only were the results from the policy research presented and discussed, but there were also presentations by the Korean experts and government officials on the related topics to the KSP project. The Azerbaijani delegation also visited and held Senior Policy Dialogues with the Ministry of Strategy and Finance, and travelled to various industrialized zones in Korea.

The Dissemination Seminar was held in Baku, Azerbaijan during 26th to 31st of July. The Korean KSP team was accompanied by Dr. Tae-Ho Bark, the Chairman of the Korea Trade Commission. Mr. Mikayil Jabbarov, Vice Minister of Economic Development, delivered the opening speech, together with His Excellency Kwang-Chul Moon, the Korean Ambassador to Azerbaijan. Dr. Tae-Ho Bark made opening remarks and actively participated in the discussions during the seminar. There were more than 20 government officials from the Azerbaijani side who are experts working on the WTO accession negotiations. Accordingly, the seminar was not open to the public, but in-depth discussions were held. A separate meeting with the Ministry of Foreign Affairs was arranged to discuss the negotiation strategies for the accession.

Final reports are included in the present report, and the following brief summary of the findings are highlighted in the remainder of this introduction.

### Sectoral Issues in Services Negotiation

In order to objectively assess the level of commitments in services, a quantitative method of evaluation was introduced, and applied to all WTO members. In view of this analysis, findings with the current (conditional) Azerbaijan offer in the services negotiation are as follows:

- General level of commitment is quite higher than the WTO member average;
- Sectoral coverage and mode 3 commitments are also higher than the WTO member average;
- However, newly acceded WTO members, which mainly belong to the Central Asia and middle income countries, including Kyrgyz, Moldova, Georgia and Armenia, have made

significantly higher level of commitment in services, even higher than that of Azerbaijan;
- Benchmark by the working party would not be the WTO average, rather the average of newly acceded members.

Based on the above findings, several recommendations are made:

- Sectoral coverage by Azerbaijan is similar to those newly acceding members, but the level of commitment is lower in the sectors of financial, construction, transportation, education and tourism services, thus further improvement would be needed in these sectors;
- Telecommunication sector has offered rather aggressive commitments, however, careful and thorough preparation would be needed during the 7-11 year transition period;
- Retail and energy related sectors did not make commitments mainly because of employment consideration, but protection may turn out to be an inefficient policy choice;
- Services offer could be an effective policy choice for regulatory reform in that the government measures in the committed sectors would be subject to Article VI domestic regulation and thus be streamlined, free from pressure by the domestic interest groups.

## Analysis of Developing Country Status in the WTO System: Implication from the Korean Experience

Findings regarding the status of developing country status in the history of WTO accession are:

- No country with similar economic situation to that of Azerbaijan in the GATT as well as the WTO system was considered as a "developed country";
- It is to be noted that Korea was recognized as a developing country as far as agriculture was concerned;
- The status itself does not guarantee lower level market concession, thus focus should be given to the content of market concession, rather than the status itself. Also, in terms of legal bindings, WTO Agreements typically stipulate longer transition periods for developing countries, instead of weaker or discriminatory obligations;
- It is to be noted that Korea has made substantial concessions in return for the status of developing country and elimination of rice from tariffication, and also that certain WTO members may opt out of the WTO Agreements under Article XIII as US has done;
- Developing country status may have less signifcance, since during the DDA agricultural negotiation, it is likely that not only developing countries, but also 'recently acceded members' receive same benefit in reducing domestic support.

Following recommendations were given for the negotiation:

- The Working Party needed to be persuaded to agree on more rational trade and economic agenda instead of provoking symbolic political matters, as this matter can cause serious domestic political risk;
- It is to be stressed that the status of developing country should be determined based on the principle, not on the matter like market access negotiation to be bargained;
- It is urgent to establish and implement industrial development strategies promptly, without being challenged under the WTO rules.

## How to Introduce and Establish a WTO-Consistent Trade Remedy System

Introduction of trade remedy measures requires more than simple enactment of key legislations, but more strategic thinking, including structural reorganization of government agencies, coordination of relevant statues, and awareness of due process requirements. From this perspective, the following guidelines are to be considered in establishing trade remedy regimes:

- Maintain consistency with WTO Agreements
- Maintain discretion of the Investigating Authority
- Focus on procedural aspects
- Consider DDA negotiations
- Consider feasibility in actual applications

Besides these guidelines, suggestions were made for specific projects to be implemented:

- Finalizing legislative preparation
- Creating Investing Authority
- Aligning investigation and reviews
- Restructuring judicial review mechanism
- Conducting feasibility test
- Active participation in the WTO dispute settlement procedure
- Review of existing measures

Since Korea has established the regime from scratch and has developed it into one of the successful agencies of the government, the Korean experience can provide some insights.

Additionally, the designation as a Non-Market Economy should be avoided, as such status would give more burden to Azerbaijan exports, and a plan to privatize major state-owned enterprises should be devised in order to escape from unnecessary subsidy allegations.

## The Strategies for Industrial Diversification through Export Promotion

Key findings on the Azerbaijan industrial structure are:

- Serious dependence on oil export, the end of oil production boom in the foreseeable future, and the signs of 'Dutch Disease';
- Industrial diversification is necessary for reducing vulnerability to price shocks, sustained employment and economic growth;
- Based on comparative advantage analysis, Azerbaijan has advantage in agriculture, agro-processing, oil-industry and chemical and petrochemical industries, and most promising export markets would be CIS countries.

In consideration of these findings and the Korean experience, it is recommended that:

- Export promotion, instead of import substitution is to be pursued to realize economies of scope and learning-by-exporting;
- Export Processing Zones could be a viable option to attract foreign direct investment;
- Sound macro-management favorable to exporters is necessary;
- Re-organizing bureaucratic systems could be an option for effective planning and implementation;
- Infrastructural development for transport and export routes are needed;
- Industry-neutral, instead of targeting, policy should be pursued.

Chapter 01

# Sectoral Issues in Services Negotiation of Azerbaijan for WTO Accession

1_ Assessment of Azerbaijan Commitments
2_ Some General Issues in GATS
3_ Sectoral Issues
4_ Summary and Conclusion
Annex

Chapter 01

# Sectoral Issues in Services Negotiation of Azerbaijan for WTO Accession

*Keukje Sung*
*Kyung-Hee University*

## 1. Assessment of Azerbaijan Commitments

### 1.1. Background of Accession Negotiation

On June 30, 1997, Azerbaijan submitted its application of accession to the WTO, and the WTO Secretariat established the Working Group on July 16, 1997. However, the accession negotiation process was not expedited as usual, and the first session of the Working Group was held only on June 2002. After the first session, the negotiation was sped up, and until July 2008, 5 Working Group meetings were held and the negotiation is still going on. Several documents were submitted to the Working Party for services, but the most important document was submitted in March 2007. The first draft for the services offer was submitted in May 2005. The most recent offer, dated March 16, 2007 is not publicly available, but the document was informally received only for the purpose of this study. During this negotiation process, services sector was not considered as one of the critical sectors, however, several concerns were raised by the Azerbaijan government; those sectors include telecommunications, audio-visual, energy-related services, and distribution services. In this regard, this study will only focus on these four sectors.

### 1.2. Comparison with Incumbent Members

Azerbaijan has submitted two National Schedules for specific commitments under the GATS. It is uncertain whether the current offer in the National Schedule is near conclusion,

depending upon the outcomes of multi-lateral and bilateral accession negotiations. However, it may be meaningful to evaluate the level of Azerbaijan commitments in the services sector from a rather macro, and objective perspective. This kind of evaluation is very hard to quantify, as the quality of services sector is difficult to measure objectively. In the past, there have been limited studies in this line of attempt.[1] The results are not widely known, nor extensively utilized, as such quantification has limits, and also, the negotiators are often more interested in their own, and immediate business opportunities, rather than academic results. Despite these shortcomings, it seems worthwhile to compare the level of commitments by Azerbaijan with those of existing WTO members in order to identify how wide and deep their commitments among WTO members and requests towards Azerbaijan are, from a rather objective angle.

Previously cited studies have adopted basically the same approach; that is for 'unbound' entries in the National Schedules, point 0 was given, and for 'none' entries, point 1 was given. The difficulty lies in cases when there are certain limitations; some entries are serious in the sense that not much liberalization is committed, while some are of technical or of little economic significance. However, studies up to now have assigned half a point for any entries other than 'unbound' or 'none'. This has a merit in that the approach places higher weights for any entries. Half a point might be considered too generous, but once commitments are made, whatever the levels are, several GATS(General Agreement on Trade in Services) including domestic regulations[2] would apply, and this kind of binding has merits. These studies tried to quantify the level of commitments to assist the negotiation process for the DDA; it can serve as guidelines or may be used to measure the degree of 'autonomous liberalization'. This report adopts the same approach.

There are 152 WTO members as of July 2008[3], and all their National Schedules are available in the WTO website. Regarding Azerbaijan, its conditional or provisional offer as of March 2007 was used. WTO members can also be classified according to their level of income and the region where they belong to. Also, among the 152 WTO members, 24 members were not original WTO members, and they had to go through accession negotiations. Thus, their commitments can serve as useful benchmarks for Azerbaijan's accession strategy.

### 1.2.1. By General Commitment Level

Specific Commitments of the 152 members were evaluated using the scoring method

1. Please refer to Bernard Hoekman, Assessment of GATS, 1995. OECD has also carried out assessment of GATS commitments, but not universally quantified the level of commitments.
2. Please refer to the 2.2 below for the meaning of domestic regulations
3. As of July 23, Cape Verde became the 153rd member of the WTO. However, her National Schedule was not available.

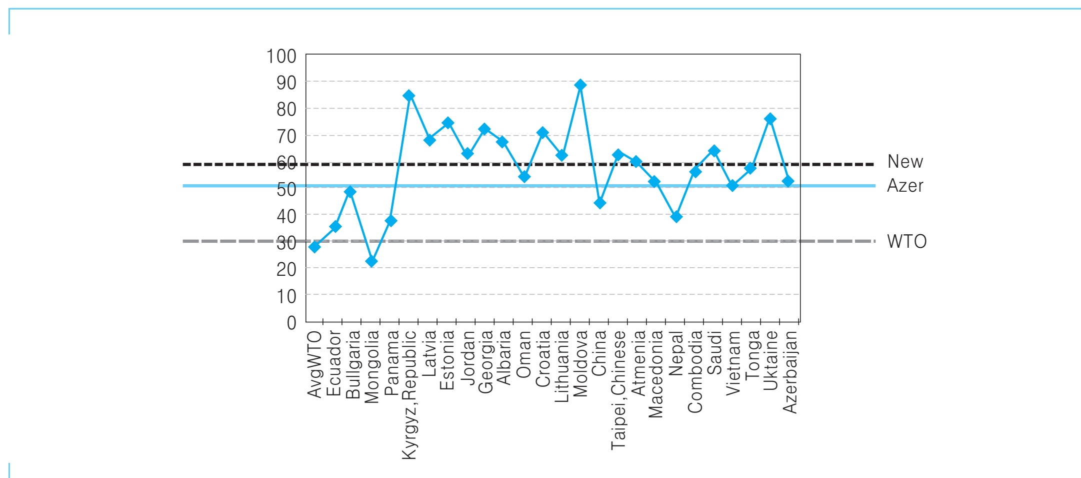
mentioned above. Among the 152 members, 12 original members of the European Union submitted only 1 offer during the Uruguay round, while new members have placed their own separate offers. Thus, 141 offers were analyzed (140 members and Azerbaijan). After scoring, a much more tough question remains; how to assign weights to different sectors, different modes (of supply) and limitations (to market access or national treatment). Once again, the simplest approach would be to give equal weight to all sectors or subsectors, modes and limitations. Even so, within a subsector, this weighting problem occurs again. By pursuing the 'equal' weight principle, sectors, subsectors or sub-subsectors were given same weights; that is all sectors were given same weights, and within a sector, and all subsectors are given the same weights. Of course, certain sectors or subsectors may be much more economically significant than others, but such importance may also vary across members. Although very simple, or even naïve, such a scoring and weighting system has merits in being simple, clear and manageable. The following Table 1-1 summarizes the assessment.

**Table 1-1 | Overall level of commitments**

| | Overall | Busns | Comm | Const | Distr | Edu | Envrn | Finan | Health | Tour | Social | Transp |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Azerbaijan | 51.3 | 63.4 | 48.2 | 68.8 | 60.0 | 33.8 | 75.0 | 41.5 | 29.7 | 71.9 | 60.0 | 12.5 |
| AvgWTO | 28.2 | 29.3 | 20.2 | 41.4 | 26.8 | 22.5 | 33.8 | 34.9 | 14.6 | 53.6 | 21.3 | 11.6 |
| RankWTO | 27 | 27 | 15 | 57 | 33 | 42 | 38 | 69 | 26 | 42 | 17 | 50 |
| AvgNewMem | 59.0 | 61.4 | 42.5 | 84.1 | 72.9 | 65.1 | 84.2 | 56.4 | 42.4 | 67.2 | 43.6 | 28.8 |
| RankNew | 18 | 14 | 10 | 22 | 20 | 23 | 18 | 24 | 15 | 12 | 8 | 22 |

Simply put, Azerbaijan has offered a significantly higher level of specific commitments; average level of commitments by WTO members is mere 28.2 (out of a scale of a 100) while

**Figure 1-1 | Level of commitments**



that of Azerbaijan is 51.3, close to double the score. If joined, Azerbaijan would rank 27th in the overall level of commitments. In terms of sectors, Azerbaijan has offered more liberalized level in all subsectors. However, relatively, financial sector was least liberalized, followed by construction, transportation, tourism and education sectors.

However, this kind of assessment may not be much meaningful for newly acceding members like Azerbaijan. More meaningful comparisons must be made against newly acceding members, as the requirements are usually much tougher for the newly acceding members than for the original members. The situation is dramatically reversed when Azerbaijan is compared to the newly acceded WTO members. As can be seen in Table 1-1, these new members have made higher levels of commitments than Azerbaijan. If included in this group, Azerbaijan would have ranked 18th out of 25 members. In almost all subsectors, Azerbaijan ranked below the average of these new members. What is more significant is the trend of commitments by new members in terms of their accession dates. Figure 1-1 shows the level of commitments by new members in the order of accession dates. As can be seen in the figure, new members since Kyrgyz have made very significant commitments, excluding Nepal and China. Existing WTO members are requesting significantly higher levels of commitments from the acceding countries as time goes by. This may be so as globalization is deepening around the world, and other commitments were made about 15 years ago, but it seems to coincide with our general impression that the new members are in general asked more than what they may deserve.

The level of commitments was also analyzed according to the level of income and region. Table 1-2 shows the result in accordance with the income level identified by the World Bank. As can be seen, and can be a priori guessed, higher income members have made higher level of commitments. Azerbaijan would be included in the lower middle or higher middle countries. Azerbaijan has offered close to double the commitments than other lower middle income countries. However, as noted previously, consideration with only newly acceded members should be given. Newly acceded members mostly belong to lower middle income groups, and they have made higher level of commitment (60.3) than what Azerbaijan offered (51.3).

**Table 1-2 | Commitments by income level**

| | Overall | Busns | Comm | Const | Distr | Edu | Envrn | Finan | Health | Tour | Social | Transp |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Low income | 21.1 | 16.4 | 14.4 | 29.5 | 17.1 | 15.9 | 19.4 | 22.4 | 14.6 | 54.3 | 19.8 | 8.0 |
| Lower middle | 27.7 | 25.6 | 20.3 | 38.0 | 24.4 | 21.5 | 34.3 | 37.6 | 15.4 | 53.4 | 21.3 | 12.7 |
| Azerbaijan | 51.3 | 63.4 | 48.2 | 68.8 | 60.0 | 33.8 | 75.0 | 41.5 | 29.7 | 71.9 | 60.0 | 12.5 |
| AvgNewMem | 60.3 | 61.1 | 42.4 | 83.9 | 74.0 | 66.7 | 92.0 | 60.7 | 35.9 | 67.0 | 47.3 | 31.8 |
| Upper middle | 27.5 | 31.1 | 25.1 | 44.6 | 19.5 | 24.6 | 24.5 | 35.2 | 9.6 | 53.6 | 14.4 | 10.0 |
| High income | 40.4 | 52.8 | 25.0 | 64.4 | 46.6 | 28.9 | 63.6 | 48.8 | 15.1 | 54.4 | 27.5 | 17.5 |

The situation does not change much when WTO members were grouped into regions. South Asia and Sub-Saharan Africa rank the lowest, while Europe & Central Asian members the highest. What is also interesting is that most newly acceding members belong to this group, and their average level of commitment (68.9) is even higher than the average of this region, which include all advanced European members. This can be identified in Table 1-3.

**Table 1-3 | Commitments by region**

| | Overall | Busns | Comm | Const | Distr | Edu | Envrn | Finan | Health | Tour | Social | Transp |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| South Asia | 14.5 | 17.3 | 11.1 | 12.5 | 9.6 | 9.4 | 11.7 | 35.6 | 11.7 | 35.4 | 3.1 | 1.6 |
| Sub-Saharan Africa | 14.9 | 11.8 | 8.5 | 20.5 | 8.4 | 9.1 | 14.0 | 14.3 | 8.4 | 52.3 | 12.2 | 5.0 |
| Latin America & Caribbean | 16.7 | 16.4 | 15.9 | 20.5 | 7.7 | 8.6 | 7.6 | 29.2 | 8.9 | 50.0 | 14.1 | 4.3 |
| Middle East & North Africa | 22.6 | 22.9 | 16.8 | 33.6 | 11.6 | 12.8 | 25.0 | 36.7 | 12.4 | 53.2 | 18.2 | 5.7 |
| East Asia & Pacific | 32.4 | 34.6 | 29.0 | 58.8 | 36.4 | 21.1 | 37.8 | 45.7 | 9.1 | 52.0 | 15.8 | 16.0 |
| Europe & Central Asia | 55.7 | 64.3 | 32.8 | 79.7 | 68.4 | 60.4 | 82.1 | 54.4 | 32.9 | 63.9 | 44.6 | 29.1 |
| Azerbaijan | 51.3 | 63.4 | 48.2 | 68.8 | 60.0 | 33.8 | 75.0 | 41.5 | 29.7 | 71.9 | 60.0 | 12.5 |
| AvgNewMem | 68.9 | 69.2 | 46.3 | 91.6 | 79.1 | 69.4 | 100.0 | 56.7 | 66.0 | 78.9 | 64.4 | 36.3 |

## 1.2.2. By Number of Sectors

The assignment of half a point for entries with 'any' restrictions may penalize entries with 'insignificant' restrictions. In this respect, we may just give the whole point to any sector as long as any commitments were made. This approach can be 'too' generous to 'significant' restrictions. However, as long as commitments are made, there are general obligations such as domestic regulations, and also the 'ratchet' effects; you cannot go back once the commitment is made[4]. Adopting this approach, a slightly different result was obtained, but not significantly different. This approach would simply count the number of sectors where any commitments were made. In this sense, this approach measures the 'sector coverage'. Following table 1-4 and figure 1-2 give the results. In this case, the number of sectors was 55, just counting sub-sectors (there are 11 sector, and 55 subsectors). Azerbaijan has made commitments in a much larger number of sectors than WTO members in general. This is also confirmed by the ranks in each sector; the lowest is just 49, while most of them are within the range of 20. This in turn would

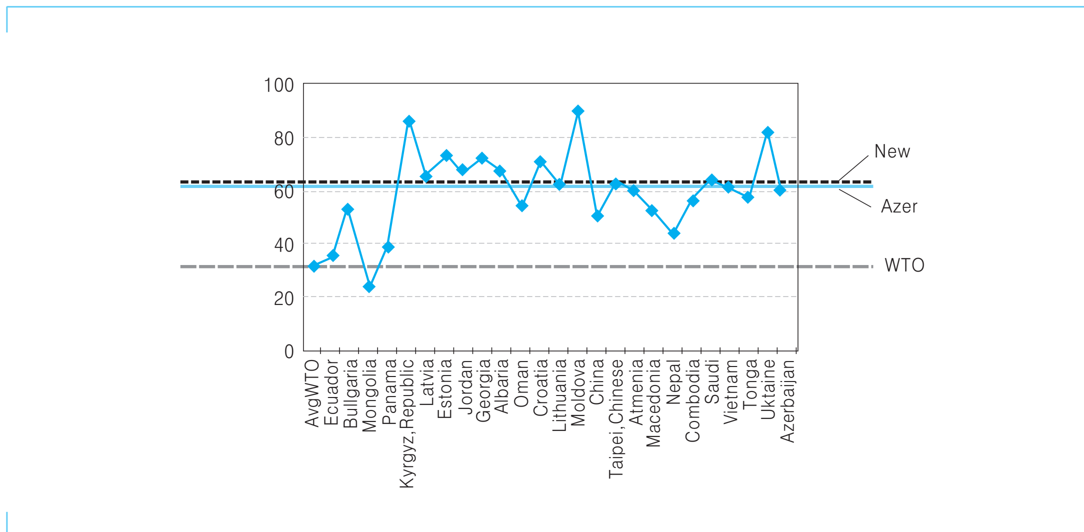
4. Theoretically, but not practically, commitments may be changed if proper compensation is given.

mean that Azerbaijan has made commitments in many sectors, but the quality of commitments is not high enough. Or, putting it differently, it has attached many restrictions, while trying to expand the number of sectors.

**Table 1-4 | Sector Coverage**

| 55 sectors | Overall | Busns | Comm | Const | Distr | Edu | Envrn | Finan | Health | Tour | Social | Transp | 154 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Azerbaijan | 62.8 | 68.8 | 53.3 | 100.0 | 60.0 | 40.0 | 100.0 | 66.7 | 50.0 | 75.0 | 60.0 | 16.5 | 54.2 |
| AvgWTO | 30.9 | 30.9 | 22.5 | 44.8 | 28.8 | 25.4 | 35.3 | 43.0 | 16.1 | 57.8 | 22.8 | 12.8 | 27.2 |
| RankWTO | 20 | 25 | 12 | 1 | 35 | 43 | 1 | 18 | 13 | 20 | 19 | 49 | 22 |
| AvgNewMem | 63.1 | 63.5 | 45.4 | 89.2 | 78.3 | 71.7 | 87.5 | 64.9 | 45.8 | 69.8 | 47.5 | 30.9 | 54.8 |
| RankNew | 14 | 11 | 6 | 1 | 21 | 22 | 1 | 3 | 8 | 5 | 9 | 22 | 14 |

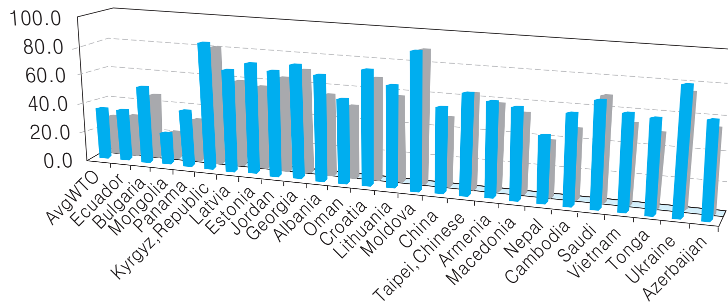
**Figure 1-2 | Sector coverage (55 sectors)**




This interpretation may make more sense when Azerbaijan is compared to the newly acceded members. Compared to the overall commitment level case, Azerbaijan ranks much higher in almost all the sectors, excluding the transportation sector. What is interesting is the coverage of sectors by Kyrgyz, Moldova and Ukraine. Their coverage is close to 90% of sectors, which is very high compared to the WTO average, which is just one-third. Once again, the general shape of the newly acceded members is the same in the previous section. New members have offered a wider range of sectors.

WTO sometimes offers the results of this approach instead of the 154 sectors and not the 55 sectors. That is, without giving any weights to sectors or subsectors, they just counted all the sectors which are listed in the WTO/GATS classification list.[5] The results are not much different from the 55 sector approach. The results are given in the last column of Table 1-4. For comparison, results from 55 sector approach and 154 sector approach are shown in Figure 1-3, and the heights of two sticks for each sectors are not much different for the newly acceding WTO members.

**Figure 1-3 |** Comparison of 55 and 154 sectors




## 1.2.3. By Mode 3 Commitments

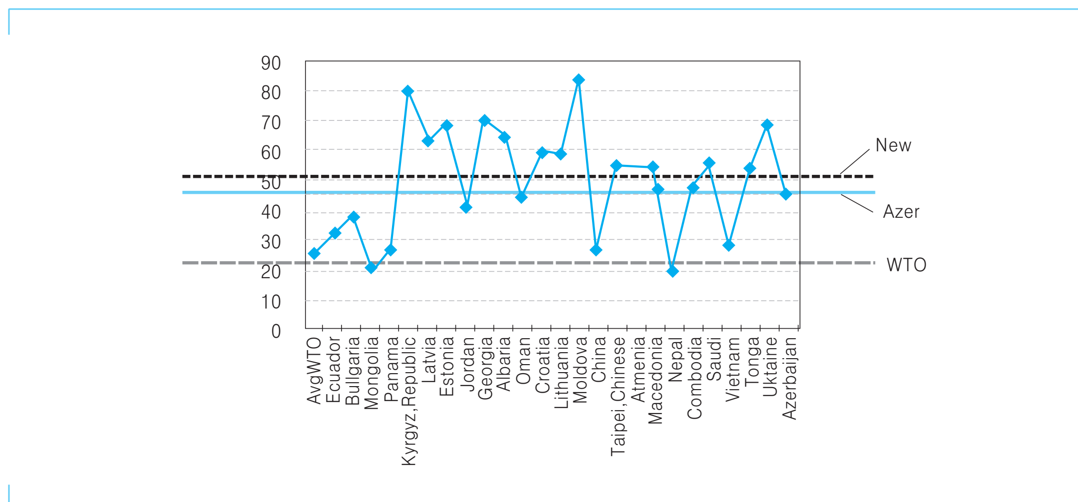
One may argue that the entries in different modes should not be given equal weights, saying that mode 3 is much more economically significant. In a general sense, mode 1 and 2 commitments may not make much difference in reality, as two modes are quite indistinguishable. Also regulations on mode 1 may not be effective at all; often you simply do not know whether the service is provided.  Almost all the members have committed similarly regarding mode 4. Also, many entries in the National Treatment column is 'none' as many restrictions are both market access national treatment limitations.  Summing up, a much more meaningful index can be obtained if mode 3 in market access column is considered. Following this idea, Table 1-5 and Figure 1-4 were obtained. What is surprising is that the results are almost the same as the case of overall commitments (the first case). The figures and rankings are almost the same as in the first case. Regarding new members, once again, Kyrgyz committed the most, followed by Moldova, and by Ukraine these days.

5. MTN.GNS/W/120

Table 1-5 | Mode 3 Commitments

| | Overall | Busns | Comm | Const | Distr | Edu | Envrn | Finan | Health | Tour | Social | Transp |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Azerbaijan | 46.39 | 57.8 | 42.0 | 50.0 | 60.0 | 30.0 | 100.0 | 37.5 | 37.5 | 62.5 | 60.0 | 9.2 |
| AvgWTO | 24.1 | 27.4 | 17.0 | 38.7 | 25.3 | 19.8 | 32.3 | 27.9 | 13.0 | 48.9 | 20.6 | 10.4 |
| RankWTO | 27 | 28 | 12 | 47 | 26 | 39 | 1 | 45 | 17 | 45 | 17 | 52 |
| AvgNewMem | 51.4 | 56.7 | 35.4 | 77.1 | 65.0 | 57.1 | 80.2 | 46.7 | 36.5 | 60.9 | 45.0 | 26.4 |
| RankNew | 16 | 13 | 8 | 16 | 15 | 20 | 1 | 18 | 9 | 12 | 8 | 22 |

Figure 1-4 | Mode 3 Commitments




As a conclusion based on the above analysis, one may say that Azerbaijan has offered a significantly high level of commitment, compared to the WTO members. But when compared to the newly acceding members, the level of commitment does not look high, and looks rather low. Especially lower middle income, European and Central Asian members have made quite significantly high level of commitments.[6] In terms of sector coverage, Azerbaijan has covered a wide range of sectors, but the depth of commitment was rather shallow, since the ranking of Azerbaijan has fallen, when full points were given as long as ‘any’ entries were made. This means that Azerbaijan has tried to cover as many sectors as possible, while in the sectors, there remain many restrictions. Further commitments would be needed for financial, construction, distribution and transportation services.[7]

6. Theoretically, the level of commitments by newly acceding members may not be high even if their sectoral coverage is high. But after reading their commitments, it is not difficult to find out that their level is quite high, as one sees many “none”s.
7. Incumbent WTO members have improved their services offer during the DDA (Doha Development Agenda) negotiation, but here we are mainly interested in the level of commitments at entry to the WTO.

# 2. Some General Issues in GATS

Before going into sector specific issues, it is worth noting that there are some general issues which need attention. First is the classification problem of the 'incidental' services, and the second is the economic significance of specific commitments in GATS.[8]

## 2.1. Incidental Services

When WTO members negotiated market-opening in services during the Uruguay Round, they relied on the classification system of the UN, the Central Product Classification (CPC)[9]. The CPC classified final products, both goods and services, in an organized manner, and provided a good basis for classification during the negotiation. The Secretariat[10] has prepared a list of service categories based on this CPC. It is the W/120 classification.[11] Although W/120 did not obtain a legal status in the sense that it did not constitute a part of the legal documents of the Uruguay Round Agreement, but it was widely accepted by the WTO members, and most, if not all, WTO members made their market-opening commitment based on that list and inscribed CPC numbers in their national schedules[12]. Since market-opening commitments in each member's national schedule are binding, any entry, including CPC numbers should be binding. In this sense, one may argue that CPC is binding in the WTO, as long as the reference is made in their schedules.

Most of the classification seemed to have satisfied negotiators' need. Of course, there were some modifications during the course of the follow-up negotiations; members came up with different classifications for certain sectors including telecommunications and maritime transportation. However, during the discussions in the Committee on Specific Commitments, questions arose as to the scope of 'incidental' services. As an example, under 1.Business Services, F. Other Business Services, there is i. Services Incidental to Manufacturing. Since they are under the heading of 'other business services', on the first look, these are simply

8. This section borrows much from Keuk-Je Sung, *The Doha Development Agenda and the General Agreement on Trade in Services Negotiation and Regulatory Reform in Korea*, Volume 2, No. 2, December 2004, Journal of International Logistics and Trade, JRI, Inha University, and Keuk-Je Sung, *A Study on the Scope of Incidental Services under the GATS/WTO*, October 2003, International Trade Law, Ministry of Justice, Republic of Korea
9. Around the end of 1980, provisional CPC was available. Currently, CPC version 1.1 is available, which followed CPC version 1.0, which in turn replaced CPC provisional.
10. During Uruguay Round, it was not the WTO Secretariat yet; it was the GATT Secretariat.
11. Official reference of the document is MTN.GNS/W/120, July 10, 1991
12. National Schedule of a member is a legal document which stipulates the market-opening commitments of that member in services.

miscellaneous services that are provided in relation to manufacturing. Many WTO members have made commitments in this category.

However, under close examination, one can find that this category of service seems to cover a wide variety of services. Specifically, it seems to cover "outsourced" production in manufacturing, which is commonly called "original equipment manufacturing (OEM)". If this turns out to be the case, then GATS is to cover not only services, but also manufacturing, and there may even be jurisdictional matters between the GATT and GATS. Since there is no definition of 'services' under the GATS, and thus if members can agree to exclude such services, such wide coverage may not matter. But it is to be noted that some members made commitments in those categories, and during the DDA negotiation in services, there are still members which made commitments in these categories. Anything in the national schedule is legally binding, and it may not be easy to solicit agreements from those members which did not make commitments that such categories be narrowly interpreted.

### 2.1.1. W/120 and CPC provisional

There are five sub-sectors in the W/120 classification which include 'incidental' services. They are:

| | | |
|---|---|---|
| 1. F. f. | Services incidental to agriculture, hunting and forestry | 881 |
| 1. F. g. | Services incidental to fishing | 882 |
| 1. F. h. | Services incidental to mining | 883+5115 |
| 1. F. i. | Services incidental to manufacturing | 884+885(except for 88442) |
| 1. F. j. | Services incidental to energy distribution | 887 |

Since W/120 did not include any explanation on the description of the sectors, one should rely on the description by the CPC (provisional). Under CPC 88 which is Agricultural, mining and manufacturing services, there are 7 Groups[13] from 881 through 887.

88 Agricultural, mining and manufacturing services
881 - Services incidental to agriculture, hunting and forestry
882 - Services incidental to fishing
883 - Services incidental to mining
884 - Services incidental to manufacturing, except to the manufacture of metal products, machinery and equipment
885 - Services incidental to the manufacture of metal products, machinery and equipment

13. 1 digit classification code is called Sections, and 2 digit and so forth are called Divisions, Groups, Classes and Subclasses.

886 - Repair services incidental to metal products, machinery and equipment
887 - Services incidental to energy distribution

Basically all services in Division 88 are included as incidental services under 1. F. f. through 1. F. j. of W/120. Exceptions are Group 886; it is under 1. F. n Maintenance and Repair Services. Group 5115 in W/120 is 'site preparation work for mining' and 88442 is 'publishing and printing, on a fee or contract basis'.

General explanation of the Division 88 (Agricultural, mining and manufacturing services) is given as follows:

*Services rendered on a fee or contract basis by units mainly engaged in the production of transportable goods, and services typically related to the production of such goods.*

*A great number and a wide variety of services are classified here which may be classified according to broad industry categories into:*

This description basically says there are two categories of services in this division; 1) any production of transportable goods, as long as such production is rendered on a fee or contract basis, and 2) services related to the production of such goods. Second category of services is easy to identify, and this category fits the usual meaning of the word 'incidental'. However, the first category seems quite broad in nature; it seems to cover all goods-producing economic activities (including manufacturing) under only two conditions; 1) on a fee or contract basis, and 2) production of transportable goods. Many of the non-services economic activities are provided on a fee or contract basis; OEM production was cited as an example before. But the ship-building industry is also characterized as customized production; most of the ocean-going vessels are built entirely on a fee or contract basis. Looking from this perspective, all goods-producing economic activities can be classified as services as long as they are provided on a fee or contract basis.

The second condition is the production of transportable goods, but most of the goods that human beings produce are transportable. Exceptions can be found in the construction like buildings, roads, ports or bridges. But construction activities are already considered as services. However, in the case of agricultural production, the goods or crops cannot be transported until they are finally produced, and a part or the whole production cannot be performed elsewhere; i.e. outsourced. In this sense, proper agricultural activities may not be performed on a fee or contract basis. Then, all economic activities[14] can be considered as services. In the case of

14. Agricultural production is excluded as mentioned.

manufacturing, they are considered as services if they are provided on a fee or contract basis; and in the case of services, they are generically provided on a fee or contract basis. If this interpretation is accepted in the GATS, then the scope of GATS application would become extremely wide, and could invite serious complications in the WTO.

### 2.1.2. CPC version 1.0 and version 1.1

The interpretation of 'incidental' services can be reaffirmed in the subsequent revisions of CPC. Division 88 Agricultural, mining and manufacturing services in CPC provisional was altered into Division 86 Production services, on a fee or contract basis in CPC version 1.0[15]. The title of the division was made more explicit, and the new Groups do not even include the language 'incidental' any more. This revision makes it clear that 'incidental' services are not just 'incidental' but rather proper economic activities.

86 Production services, on a fee or contract basis
861 - Agricultural, hunting, forestry and fishing services
862 - Mining services and electricity, gas and water distribution services (on a fee or contract basis)
863 - Manufacturing services, except of metal products, machinery and equipment
864 - Metal product, machinery and equipment manufacturing services
865 - Installation services (other than construction)
869 - Other manufacturing services

The latest version in CPC is version 1.1. On the first look, CPC version 1.1 seems to have regressed to the CPC provisional because the language 'incidental' appears again, but only with non-manufacturing activities. In the case of manufacturing activities, however, it makes no use of 'incidental' or 'on a fee or contract basis'. Now it simply stipulates manufacturing services 'on physical inputs owned by others'.

8 Business and production services
81 - Research and development services
82 - Legal and accounting services
83 - Other professional, technical and business services
84 - Telecommunications services; information retrieval and supply services
85 - Support services
86 - Services incidental to agriculture, hunting, forestry, fishing, mining, and utilities
87 - Maintenance, repair, and installation (except construction) services

15. This was adopted in 1997. CPC version 1.1 is in effect from May 2002.

88 - Manufacturing services on physical inputs owned by others

89 - Other manufacturing services

## ISIC

CPC provisional, version 1.0 and version 1.1 can be matched among themselves, and all sub-classes in CPC's can also be matched with the industrial classification system, ISIC (International Standard Industrial Classification). Through closer examination, one can find that all manufacturing activities correspond to CPC's 'incidental' services. As an illustration, we may compare CPC provisional and ISIC rev. 3. There are 60 Divisions in all in ISIC rev. 3, and all Divisions beyond 30's are considered as services; there are 29 of them. In Agricultural, hunting and forestry, there are 2 divisions; in Fishing, 1 division; in Mining and quarrying, 5 divisions; and in Manufacturing, 23 divisions. All these 31 non-services divisions in ISIC correspond to CPC provisional 88. If there are exceptions, they are proper agricultural activities, which cannot be performed elsewhere. They are;

011 - Growing of crops; market gardening; horticulture

012 - Farming of animals

013 - Growing of crops combined with farming of animals (mixed farming)

## UN Expert Meeting

In October 2000, an Expert Group Meeting was held to discuss the extent of Division 86 (CPC revision 1.0). In that meeting, it was discussed that the general case of goods production generally involves the following four elements; the production unit has

*1) designed or the rights of development of which it has bought*

*2) buys the necessary raw materials*

*3) uses its proper means of production to make it*

*4) ensures its commercialization under its name, that means, assumes the commercial responsibility of the product and the commercial risk*[16]

But as businesses tend to 'outsource' a part or the whole operation according to their strategy, such simplistic view of production no longer describes the reality, and there appeared many activities in the industrial production which do not satisfy the 4 criteria above. These activities are the ones that are provided on a fee or contract basis. It seems reasonable to require only two conditions to qualify as a production on a fee or contract basis. They are:

- the elementary operations or the complete production, eventually including the provision of

16. Commercial responsibility means the one for defective products, and commercial risk means the success of the sales.

the raw materials, are paid for and not the output;
- the ownership of the output is the customer's.

The sub-contractor is a producer, and so is the owner of the output, who was the principal of the sub-contractor. Both are producers, but one is a service provider, while the other is not a service provider. Under ISIC, both are producers in the same industry, while under CPC (which only deals with the final output), the sub-contractor produced 'services' and the principal produced 'goods'. Thus by definition, production on a fee or contract basis on the account of a third party, total or partial, exists in any sectors, be it goods productions or most of the services, even including the administrative deregulation.[17] This is the general interpretation by the UN experts.

## 2.1.3. Commitments by WTO members

During the Uruguay Round negotiation, many members made market-opening commitments in 'incidental' services. As of 1999 when a CD-ROM is available for market-opening commitments, there were 126 WTO members, and around 40 members inscribed entries in the Division 88. The following is the summary of the current[18] commitment.

**Table 1-6 | Offers in Incidental Services during UR**

| Sector | Full Commitment | Partial Commitment | Total |
|---|---|---|---|
| Services incidental to agriculture, hunting and forestry | 18 | 20 | 38 |
| Services incidental to fishing | 12 | 15 | 27 |
| Services incidental to mining | 22 | 10 | 32 |
| Services incidental to manufacturing | 14 | 7 | 21 |
| Services incidental to energy distribution | 7 | 3 | 10 |

Here, full commitment means that the whole sub-sector was included in the national schedules, while partial commitment means that only part of the sector was included; in most of the cases, they limited the scope of the service to consultancy or advisory activities. What is interesting to note is that most of the members which made full commitment are developing country members, and most of the members which made partial commitments are developed country members. Of course, there are exceptions; US may be the only developed country member which made full commitments in all sectors. But, the US did not mention anything on the CPC numbers, and it is possible that the US may argue that the word 'incidental' here and that in the CPC do not have the

17. Italicized portions are largely quotations from the remarks in "Note on CPC Division 86" by E. Bruneau, INSEE, United Nations, October 13, 2000.
18. As of 1999.

same meaning. Also interesting is that Japan has not made any commitments.

In general, more members made partial commitments than full ones in the agricultural and fishing sectors. In contrast, more members made full commitments than partial ones in the mining and manufacturing sector. It is not clear whether the members were fully aware of the consequences of their commitments during the UR. Energy sector has the smallest number of commitments. This kind of pattern seems to continue in the DDA negotiations, since the analysis of 20 major trading members' initial offers[19] reveals similar pattern, as follows;

**Table 1-7 | Offers in Incidental Services during the DDA**

| Sector | Full Commitment | Partial Commitment | Total |
|---|---|---|---|
| Services incidental to agriculture, hunting and forestry | 6 | 9 | 15 |
| Services incidental to fishing | 3 | 7 | 10 |
| Services incidental to mining | 9 | 4 | 13 |
| Services incidental to manufacturing | 4 | 3 | 7 |
| Services incidental to energy distribution | 1 | 2 | 3 |

### 2.1.4. Discussions in the CTS

WTO has been established in 1995, as a result of the UR negotiation. In the WTO, most of the decisions are made by three separate councils, which oversee trade in goods (Council for Trade in Goods), trade in services (Council for Trade in Services) and the protection of intellectual property rights (Council for TRIPs). Under the CTS, there are several working parties and committees. One of the committees is the Committee on Specific Commitments (CSC), and it deals with all the matters related to Specific Commitments. Since the classification is directly related to the specific commitments, the classification issue was dealt with in the CSC. This issue of 'incidental' services has been known among members for a while, but serious discussions started only after the GATS Secretariat submitted a background paper in July 2000.

The GATS Secretariat circulated a paper in July, basically categorizing services related to manufacturing into three categories; (i) manufacturing on a fee or contract basis; (ii) services incidental to production, which constituted part of the production process; and (iii) various

19. They include Australia, Canada, Chile, EC, Hong Kong SAR, Iceland, Israel, Japan, Liechtenstein, Mexico, New Zealand, Norway, Paraguay, Poland, Singapore, Switzerland, Taiwan, Thailand, Turkey, Uruguay and US.

services relating to production, which were supplied to manufacturers. Among these three categories, the third one has no ambiguity, while the first two could carry some ambiguity. The Secretariat has pointed out that although the CPC classified all these activities, including manufacturing on a fee or contract basis, as services, this fact alone could not mean that they should all be considered as services subject to the GATS. It is true that there is no legal definition of services in the GATS, and thus CPC may have no place in the GATS. Thus, the Secretariat has stated that the inclusion of the first and second categories was a matter for decision by members. This explanation by the Secretariat came rather as a surprise since many WTO members have already made commitments according to the CPC, and they are inscribed in the legal documents of National Schedules. In fact, some members expressed this concern during the committee meetings.

Those members who inclined to exclude the first two categories of services out of the GATS pointed out that the general obligations under the GATS can give quite a burden to the members. Consider the transparency and domestic regulations obligations; all the laws, decrees, and measures by the Government related to not only services, but also manufacturing sectors should be published, notified and streamlined according the domestic regulation provisions. This matter may be even more complicated if there are conflicts between the GATT and GATS. Subsidy may also add to the complexity of the issue.

If some manufacturing activities are included as services, then the following questions should be answered; (1) the possibility that all manufacturing activities may actually be subject to the GATS, if performed on a fee or contract basis; (2) if there are subsidies to certain manufacturing activities, care must be taken, unless those subsidies are listed in the national schedule; (3) if a foreign investment is made in a company producing on a fee or contract basis in the manufacturing sector, relevant GATS provisions and mode 3 commitments can apply; (4) attention must be given to the MFN obligation; this obligation is applied without any commitment in the schedule; (5) tariffs imposed on goods manufactured on a fee or contract basis may restrict the cross-border supply of a service. All these are quite serious questions. Also there was a question that CSC may not have the mandate to reach formal conclusions on such matters and that the general discussion on production on a fee or contract basis in the CSC had already reached the limit of its productivity. Considering the difficulties and complexities of the issue, WTO members generally agreed that the issue is not a matter of priority at that time, and the CSC agreed on May 9, 2001 to suspend consideration of manufacturing on a fee or contract basis without drawing any conclusions.

### 2.1.5. Suggestions and Concluding Remarks

The Uruguay Round of negotiation, the most ambitious multilateral negotiation in history, has given birth to an international agreement on trade in services; the GATS. Since 'services'

are different from 'goods' in many respects, a trading agreement in services was difficult to establish even though GATS borrowed many concepts from the GATT. As an example, services cannot be traded across the border as goods can; you cannot pack construction services and export them. Considering these difficulties, GATS 'defined' trade in a different way; 'trade in services' is the 'provision of services by foreign service suppliers'. Care has been given to the structure of the GATS to avoid conflict with GATT during the UR negotiation, however the classification of services has not been given enough attention, and 'incidental' services are good examples.

It is generally thought that the GATT is on the goods trade, and the GATS on the services trade. Continuing to think in this context, the classification of services was based on the CPC which classifies products. But the pitfall was in the dual nature of services; services are products or outcome of economic activities, but at the same time, they are economic activities. In the case of manufacturing activities, they are economic activities, but not the products. Thus, if certain economic activities are performed 'on a fee or contract basis', then they are classified as 'services' under the CPC. It is true that the GATS has no definition of services, and CPC has no legal appearance in the GATS. But, there are many members which made market-opening commitments already, and many more members are still making offers in the 'incidental' services following CPC in the ongoing DDA negotiations. Since commitments are also a part of legal documents, it can be argued that CPC has legal status in the GATS negotiation.

One may disregard all these considerations as just an intellectual exercise, and not many reasonably minded members would insist that pure agricultural activities are also services. Also, it is true that no negotiators expected that manufacturing could be brought into the GATS. But the reality is that some manufacturing (and others) is already in the realm of GATS, and if some real substantive interests are at stake in the future, this issue can have real relevance. At the moment, members decided not to open this issue for the time being without any conclusion, but the decision should be made sooner or later in a more explicit manner.

## 2.2. Domestic Regulation and Regulatory Reform

Developing country members in general do not show much interest in services negotiation, mainly because the negotiation is for the expanded market opening. If the market opening is for the reduction of tariffs on manufactured goods or agricultural products, then some, if not all, developing countries may benefit from further liberalization. However, when the topic is for the liberalization of services, then the benefits to the developing countries would be very limited. Of course, if developed countries allow more service providers from developing countries, they may develop interest in the services negotiation. Apart from this possibility, it is generally believed that developing country members do not have competitiveness in services, and

accordingly they could be quite reluctant to participating in the services negotiation.

Economists generally argue that trade liberalization is good for all the countries involved, since free trade would allow more trade, which offer wider choices for consumers and allow the most efficient producers to concentrate on their specialty areas. Such a view rests on the time-honored economic principle of Comparative Advantage Theory by David Ricardo. Can developing country members be persuaded by such a theory? Does the general public believe in such a theory? If the answers to these questions are not affirmative, then there must be some other reasons why developing country members should participate in the negotiation. This part tries to answer this question from a different perspective, namely from the perspective of regulatory reform. It is true that even if this new perspective is satisfactory, the question whether the general public can be persuaded of such perspective is quite another matter. However, if we can have a new and different answer, such an answer can definitely add to the reasons why developing country members should participate in the services negotiation.

### 2-2-1. Approaches to Liberalization under GATS

Liberalization of trade means reduction or elimination of trade barriers. In the case of the GATT which oversees trade in physical, tangible goods, trade basically means cross-border trade, and the barriers are mostly found at the border; tariffs, quotas, standards conformity testing, customs inspection, customs valuation, and so on. However, in the case of the GATS, it includes a mode where services are provided in a country after a company is established. The foreign service supplier is just like the ordinary local service supplier. It is called "commercial presence" (mode 3)[20]. Thus, if we pursue liberalization under the GATS, we have to consider the removal of all domestic regulations which affect the provision of services. This is a formidable task, and for many members, this would be viewed as infringement over their sovereignty.

GATS negotiators recognized the subtleties and difficulties, and came to devise a mechanism how liberalization can be pursued under this circumstance. First some terminologies need to be defined. The GATS is to be applied to "measures" by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form. Among these measures, some may be trade restrictive while others are not; not all measures are to be streamlined or removed, and such removal would be impossible in practice. Negotiators identified rather certain trade-restrictive measures which need to be negotiated for removal, and

20. There are four such modes. Mode 1 is called cross-border supply, mode 2 consumption abroad, mode 3 commercial presence, and mode 4 movement of natural persons. Mode 2 refers to the cases where consumers move abroad to receive services, and mode 4 refers to the cases where foreign individuals move into other countries and provide services. What is important in these modes is that all four modes are defined as "trade in services", not the provision of services in the ordinary sense of the words.

let all the remaining measures be streamlined according to certain principles.

Those measures which need to be removed (of course, through negotiations) are called "restrictions" or "limitations" and there are two types of limitations (hereafter it is called "limitations"). The first one is limitation on market access, and the other is on national treatment. Limitations on national treatment are rather straight-forward; they are discriminations against foreign services or service suppliers. In GATS, Article 18 stipulates:

*In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.*

Conditions and qualifications set out in the National Schedules of Specific Commitment are the limitations in the meanings discussed here. Of course, the limitations include de jure and de facto discriminations. But discrimination here does not include any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.

The second type of limitation is on the market access. Limitations in this type, in contrast to the national treatment, are exhaustively listed in the Article 16 of the GATS. That is, a measure will be market access limitation if it falls into one of the categories listed in the Article 16, and if not, it is not a market access limitation. There are six categories and they are:

*(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;*

*(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;*

*(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;*

*(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;*

*(e) measures which restrict or require specific types of legal entity or joint venture through*

*which a service supplier may supply a service; and*

*(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.*

On close examination, it is not difficult to note that (a) relates to the number of suppliers. (b), (c) and (d) are the limitations on the operation of the business in volume and quantitative forms, and the number of employees respectively. (e) is a limitation on the form of the establishment and lastly (f) is a foreign equity limitation. One should note that all these limitations are on the maximum, not on the minimum quantitative restrictions. If there are limitations on the minimum, they are usually considered as measures to ensure the quality of the service suppliers. Of course, if the minimum is too burdensome, that measure can be challenged under the Article 6 Domestic Regulation, which will be explained below. Another point to note is that all except (e) can be expressed in terms of numbers. In this sense, market access limitations are basically numerical limitations or in the terminology of the GATT, quantitative restrictions. This logic also applies to 'economic needs test' in (a) through (d). They are usually in the form of formulas. Many members, however, interpreted this 'economic needs test' as meaning 'discretionary criteria' to be exercised by the licensing authority, but what negotiators had in mind was a limitation which can be expressed as a formula such as 1 supplier per 1,000 residents.

Now, GATS approach to liberalization proceeds as follows. First, a member should determine which sector is to open to foreign competition. Of course, the choice of sectors has to be negotiated with trading partners. Once a sector has been chosen, then the member should review all government measures pertaining to this sector. Then, the member should identify any discriminative measures against foreign services or service suppliers. After such identification, it has to check whether there are measures which fall into one of the 6 categories in the Article 16. These discriminative measures and 6 type measures constitute the limitations to national treatment and market access. Depending upon the outcome of negotiations, a member may maintain all or part of limitations. These limitations are inscribed in the National Schedule of Specific Commitments.

### 2.2.2. Domestic Regulation and Regulatory Reform

There are numerous measures in the services sector in any country, and only a small set of measures will make limitations on the national treatment or market access. In fact, most of the measures are on the qualification or licensing procedures. Most of the measures are not limitations to national treatment or market access, and these measures need not be negotiated to remain as government measures. Government may maintain any such measures, and no trading partners are entitled to request to remove such measures. However, Article 6 stipulates that such

remaining measures should be administered in a reasonable, objective and impartial manner. Moreover, all qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, and such requirements are, inter-alia:

*(a) based on objective and transparent criteria, such as competence and the ability to supply the service;*
*(b) not more burdensome than necessary to ensure the quality of the service;*
*(c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.*

However, these requirements do not apply to all government measures, but only those measures in the sectors where specific commitments are made. Let's suppose that there is a measure which a member wants to maintain. If that measure is a limitation to national treatment or market access, then through negotiation, a member may maintain the measure. If the negotiation was not successful, then such a measure cannot be maintained. But when the measure is not a limitation, then a member may maintain the measure, but the measure should be administered according to Article 6. Of course, if the sector is not on the National Schedule, then Article 6 basically does not apply, and the member does not have any obligations[21]. If there are specific commitments in the sector, then trading partners may request the removal of the measure if they believe that the measure was not administered in accordance with Article 6.

At present, Article 6 has only abstract principles, and it is not clear whether these principles would be operational in actual implementation. The GATS mandates members that they start negotiation to develop detailed principles. This Article 6 seems most controversial to the eyes of the opponents to the GATS. Indeed, this article lies at the heart of the assertion that 'additional constraints on "domestic regulation" are among the most serious new threats to democracy posed by this round' as remarked by some NGO's against services liberalization and also globalization. This kind of allegation is not without ground, but in reality no government may deny that their measures should satisfy the criteria in the Article 6. In fact, these are the criteria every government in the world pursues during their regulatory reform.

The way liberalization is pursued under the GATS has important relevance to the regulatory reform. In the introduction above, we asked a question why WTO members, especially developing country members should participate in the negotiation. The first rationale was based on comparative advantage. It is generally argued in the WTO that developing countries have comparative advantage in the tourism sector and the human services sector. Regarding the

21. Some obligations such as transparency and MFN still apply.

tourism sector, it is a global trend that all countries try to liberalize the sector to attract foreign capital and foreign tourists. Also they are not the developed countries' restrictions that inhibit trade in this sector, but the restrictions in the developing countries themselves. Some members alleged that unfair practices by transportation carriers, travel agencies or multinational hotel chains of developed countries prevent developing countries from benefiting tourism. But even such claims have something to do with the competition safeguards, not the market access or national treatment limitations. Regarding movement of natural persons, developing countries strongly demand that developed countries should significantly expand their current offer in this mode. It is true that developing country members would benefit if the commitments are expanded, but movement of people also entails many social and political difficulties in many developed countries. It necessarily invites immigration aspects. There would be limitations to this effort in the end.

The next argument for participation could be that liberalization increases efficiency in the economy as a whole. Some of the services sectors are important in themselves, as they are huge, but they are also important in supporting the manufacturing sector. They are mostly in the infrastructure services, such as distribution, telecommunication, transportation, construction and financial services. Without proper development of these sectors, manufacturing and even agricultural sectors cannot sustain growth. This is a very important economic argument, and Korea has emphasized this argument during the services negotiation. But the response was not warm enough, since the effect of such increased efficiency would be felt only in the longer term.

In addition to this argument, it is argued here that the liberalization approach under GATS squarely fits the regulatory reform efforts of a country. There is not a generally agreed definition of regulatory reform, but we can turn the question around. That is, if a regulatory system does not impose restrictions including numerical quotas, and if the rules of the game are reasonable, objective and impartial, then such a regulatory system successfully passed the test of regulatory reform. If we accept this criterion, then that is exactly what GATS is pursuing. You set up rules, there are no numerical restrictions, and they leave the market alone. But if they violate the rules, then you punish them. Do not prejudge what is the desirable outcome beforehand and set up quotas based on pre-judgment. Moreover, all these approaches are committed not only to yourself, but to the outside (foreign) players, and it is practically impossible to reverse these rules.

Under this approach, three points need to be elaborated a little further. First is the identification and elimination of numerical restrictions. Regulatory reform is based on the market economy principle, and the market economy principle is in turn based on free competition. The most direct and distortive barrier to free competition is numerical quota. We have seen over and over that market is very much distorted when there are entry barriers, and

numerical quotas directly give rise to such entry barriers. As pointed out several time before, GATS approach puts highest priority to the identification and elimination of numerical quotas. This is one of the reasons why GATS is based on the market economy principle and serves the purpose of regulatory reform. Next is the principle of how government measures should be administered. Although the GATS domestic regulation has set forth only general principle that all measures be administered in objective, reasonable and impartial manner, this would create significant constraint to the administration of government measures. Also, because it is general, it is hard to deny for any government that they would not follow this principle. On the other hand, if the principle is too general, one may think that it may not have practical impact. However, if there arises a dispute, and panel examines the case, then it is not difficult to expect that the panel would scrutinize the case and all related matters will be publicly known. This can create another pressure to the governments. Last is the nature of commitments in the WTO. Once the commitment is made, it is virtually impossible to retreat from it. It is said in the WTO that WTO is a place to play a "permanently and legally binding game'. Many, if not all, reforms fail, because they were reversed when the resistance from the interest groups are strong. You are basically tying your hands by making commitments in the WTO. All these aspects show that GATS negotiation process can be a handy instrument in regulatory reform of the services sector.

This kind of approach can be viewed by some people as an intrusion into the national sovereignty. But if we want regulatory reform, and if we do not want interest groups to exercise their rent seeking power, this is what you should do, even without GATS. With the GATS, your intention and determination to reform is reinforced. You bind yourself internationally, and permanently.

### 2.2.3. Suggestions and Concluding Remarks

It was attempted here to develop an argument why a developing country should participate in the services negotiation. It was argued here that free trade is beneficial to all the members concerned, but the political economy does not allow us to engage in free trade. In this regard, assessment capacity of investment projects by financial sector is quite critical. Developing countries especially lack of these expertise in the financial sector. The usual argument in favor of free trade is the increased benefit from comparative advantage, and increased efficiency of an economy, but those would not be enough to persuade the negotiators and the general public. Here, the GATS liberalization approach has been analyzed from the perspective of regulatory reform, and it was argued that GATS liberalization can be a very appropriate instrument for the regulatory reform from three aspects; market-based reform, regulatory principle, and irreversible commitment. It is true that this argument may be persuasive to negotiators and regulators, but not to the general public. Even so, it gives a good rationale to them regarding why they should actively participate in the services negotiation.

The aspect of irreversible commitment is particularly important to developing countries. It is quite common that powerful interest groups exist in developing countries, and often they exercise political clout to reverse certain policies to their benefit. In developing countries, there is virtually no one who can resist such pressure. But if the commitment is made in a multilateral forum, such pressure can easily be denied. In fact, there were several occasions in the WTO, although not recorded, where developing countries voluntarily made deeper commitments beyond their ability to resist such domestic pressure.

In liberalizing trading regimes for developing countries, several additional considerations are also important. First is the MFN principle. That is, if liberalization is pursued, then the opportunity should be given not just to a limited number of foreign countries, but to all foreign countries. If limited opportunities are given, those foreign firms will quickly convert into another powerful local firm. The benefit from liberalization will not be realized. Next is the ineffectiveness of gradual liberalization. Often gradual steps are taken for liberalization to minimize the cost and for smooth transition. Such gradual approach does have merits, but if the steps are further apart, then protectionist pressure revives in, and liberalization will stop there. Last point to bear in mind is that firms will always find ways to realize their profit opportunities. That is, if proper incentives are not given, any regulation may be circumvented, even if it is illegal. If the regulation goes against market incentives, it would not work.

# 3. Sectoral Issues

## 3.1. Telecommunications

### Regulatory System

There are 10 telecommunication carriers in Azerbaijan; 6 in fixed line business, and 4 in the wireless business. All carriers have licenses to build their own facilities. However, there are geographical limitations for their operations. Among the 6 fixed line operators, Baktelecom is the largest, and the remaining four carriers are small and operate only in the city of Baku. Aztelecom, which was established later than Baktelecom, is the sole provider of long distance and international services. Wireless carriers may provide all range of services, but they may own facilities only within the city of Baku. In this regard, there are basically two major suppliers, Baktelecom and Aztelecom.

Interconnections with non-major suppliers are allowed under negotiated agreements with the two major suppliers. However, both major suppliers are government owned, and since there are

no alternative facilities to provide effective local, long distance or international services than to interconnect these two major suppliers, governmental intervention and direction can play a major role in the telecommunication business. It is said that up to present there are no major complaints or disputes among telecommunication carriers, but it may also be a reflection that the government holds very strong leverage in this sector.

Azerbaijan offered an ambitious commitment in the telecommunications sector; basically it offered that after 7 and 11 years after the accession, all limitations in the sector will be removed, and reference paper will also be fully observed. Liberalization per se and competition safeguards are desirable for the development of the industry, however, careful preparation for the introduction of competition should be taken into consideration.

In the case of Korea, competition in the basic telecommunication sector has been introduced some 20 years ago, and all the telecommunication carriers are now privately owned. Also an independent regulatory body, Telecommunication Commission was established (now merged with Broadcasting Commission as of February 2008). However, close examination of the work of the Telecommunication Commission reveals that this regulatory body does not function as a regulator, but simply a subordinate agency of the relevant ministry, except that they oversee mostly excessive subsidies by carriers to attract customers, and small consumer complaints. Simply put, the ministry still exerts influences in the telecommunication sector. It takes a long time for private carriers to establish business practices.

Another reason why there were not many disputes among carriers was that there are no major foreign participants in the industry. Telecommunication carriers are very keen to the terms and conditions of interconnection, especially the access charges, because a favorable arrangement would bring them guaranteed profits. However, if there are only local interests, then they may tacitly cooperate with the major suppliers, especially if they are government owned. But when those carriers are privatized, and if foreign interests are involved, negotiations on interconnection can become very sour. The first telecommunication dispute under the WTO regime between USA and Mexico illustrates this point.

### Telecommunication Annex and Reference Paper

Once Azerbaijan joins the WTO, Telecommunication Annex should be observed as it is part of the WTO obligations, and the Reference Paper should also be abided by if Azerbaijan commits to it. A majority of WTO members (77 of them) have made commitments in the basic telecommunication sector, and almost all of them have made full commitments under the Reference Paper (64 members). Among the original WTO members, it is said that Bangladesh and Thailand have not committed the Reference Paper, while India, Indonesia, Malaysia, Pakistan and The Philippines have made partial commitments. Among the newly acceding

members, Panama and Mongolia have not made commitments, which joined the WTO in 1997, while all new members have made full commitments. In this respect, it would be quite difficult for Azerbaijan not to adopt the Reference Paper in full.

The following table shows the level of commitment by Azerbaijan in the communication sector. Azerbaijan has made significant commitment in the sector, even compared to the newly acceded WTO members. Indeed, Azerbaijan maintains only one restriction on the representation in the international organizations, even after 7 or 11 years.

**Table 1-8 | Level of Offers in Communication Services**

| | Postal | Courier | Telcom | A/V | Othr | Level | Cvrg(55 sect.) |
|---|---|---|---|---|---|---|---|
| WTO | 7.1 | 35.7 | 44.5 | 10.0 | 3.5 | 20.2 | 22.5 |
| NewMem | 23.2 | 81.0 | 81.6 | 22.7 | 4.2 | 42.5 | 45.4 |
| Azerbaijan | 0.0 | 100 | 82.5 | 58.3 | 0.0 | 48.2 | 53.3 |

The obligations under the Telecommunication Annex and the Reference Paper are summarized in the Annex 1. There are many government measures which are to be prepared or established before full competition is introduced.

### Specific Commitments in the National Schedule

The wordings in the National Schedule should also be carefully drafted. Many members have inscribed measures in the national schedules, but often, those entries do not qualify as limitations. Only six types of market access limitations and national treatment limitations are eligible for the entry. Also, some members, especially developing country members, thought that the Reference Paper would only apply to domestic interconnections. Also, they attach importance to the chairman's note[22] on the international settlement rates. Thus, they thought that the settlement rates are completely outside of GATS. However, the dispute between USA and Mexico showed that the international settlement rates can be governed by the GATS. Please refer to the summary findings from the US-Mexico dispute case in the Annex 2.

## 3.2. Distribution

Azerbaijan has made offers in the distribution sector in commission agent, wholesale and franchising services, but quite unlikely from the usual pattern of offer in this sector by the other

22. Group on Basic Telecommunications, Report of the Group on Basic Telecommunications, S/GBT/4, 15 February, 1997

WTO members, it has not committed in the retail sector. As can be seen in the following table, Azerbaijan's offer was quite impressive, if there were commitments in the retail sector. Among the 152 members, 55 members have made commitments in the wholesale sector and 52 members in the retail sector. Only Ecuador, Panama and Peru have not made commitments in the retail sector while wholesale sector was committed; Hong Kong has not made commitments in the wholesale, but has in the retail sector.

Azerbaijan has concerns in the retail sector as the sector is mainly run by refugees or poor people, who are running the business in very small scales. The concern is understandable, however, non-commitment needs not be the only solution to protecting this sector. In the case of Korea, retail sector was also dominated by very small scale family businesses, and occupied large portion of employment. This kind of concern led Korea during the UR not to make liberal commitments in the retail sector. However, Korea has made advanced commitments, where complex system of regulations is to be gradually liberalized according to the time schedule. Close to 15 years after the UR, Korean retail sector has shown gradual and rather smooth transition to a much more efficient and modernized pattern. Large scale retailers have moved in, and small scale retail shops have formed coalition, and both are surviving from the competition. Of course, the benefit goes to the consumers. In this respect, it is advisable that the offer be made, but with a rather longer transition period.

**Table 1-9 | Level of Offers in Distribution Services**

| | ComAgnt | Whole | Retail | Frnchs | Other | Total | Cvrge |
|---|---|---|---|---|---|---|---|
| WTO | 26.8 | 36.2 | 34.4 | 29.4 | 5.9 | 26.8 | 28.8 |
| NewMem | 79.4 | 94.5 | 87.0 | 85.2 | 18.2 | 72.9 | 78.3 |
| Azer | 100.0 | 100.0 | 0.0 | 100.0 | 0.0 | 60.0 | 60.0 |

## 3.3. Audio-Visual

Audio-visual sector is one of the most rapidly changing sectors due to the development of digital technology. The development in this sector merges telecommunications and broadcasting sectors; it is called the convergence of telecommunication and broadcasting. Such a convergence calls for the need of streamlining and harmonizing regulations in both sectors. However, the telecommunication sector has introduced much liberalization, while broadcasting sector did not. On the other hand, broadcasting sector not only contains transmission services, but also contents services. Because of this contents aspect, broadcasting sector still remains under heavy regulations in many countries.

Audio-visual sector in the GATS shows a very low level of commitment compared to other sectors; WTO average is just 10, while the overall average is 20.2. For Azerbaijan, it has made commitments in the sector, and the level is quite high, even compared to the newly acceding members which showed very high level of commitments. Indeed, only 29 members out of 152 members have made commitments in this sector, and as many as 30 members have sought MFN exemptions in the sector. This kind of low level commitments may be interpreted as lack of coherent regulations due to the new convergence, but convergence was called into question only recently. During the UR, not many members were aware of the convergence. The most immediate concern was the aspect of cultural diversity. Many WTO members, especially EC and Canada, were concerned by the dominance in the Hollywood movie industry, and tried to protect their movie industry in the name of cultural protection. Recently there was an international declaration on the protection of cultural diversity[23].

It is not clear whether a country can preserve its cultural diversity only by protecting their movie industry. In the case of Korea, the movie quota system was in place for a long period of time, not under the GATS but under the GATT (Article 4). Some argue that such a quota system contributed to the rise of Korean movie industry, as local films occupy more than 50 percent of the market, while in most countries, local films occupy much less and dominated by Hollywood movies. In Europe, US movies occupy more than 70% of the market. However, it is still controversial as to whether such restriction was a determining factor for the development of the Korean movie industry. For the negotiation of Free Trade Agreement with the US, the Korean government agreed to reduce the quota to half (from 146 days to 73 days), and the market share by local movies showed irregular pattern. Thus, it is hard to say that there is any significant relation between the screen quota and the market share by foreign movies.

It is said that Azerbaijan considers becoming a member of EU in the future. If that is the case, commitments in the audio-visual sector may complicate the accession procedure to the EU, as the EU as a whole has sought MFN exemption in this sector. Although Azerbaijan may consider withholding commitments in this sector, negotiating partners, especially, United States, may request expanded offers in other sectors in return.

## 3.4. Energy

Azerbaijan has not committed any services directly related to the energy service. Its main concern is the protection of the energy sector, but the negotiating partners may have disagreements if an oil producing country like Azerbaijan wants to protect the energy sector. Regarding the energy sector, it is to be noted that the current DDA negotiations do not single

23. UNESCO, Universal Declaration on Cultural Diversity, 2001

out and negotiate the energy distribution or mining; instead the WTO members have adopted the cluster approach and negotiate as a whole the following energy related sectors. They are as follows:

1. **Services incidental to mining:** CPC 883+5115;
2. **Related scientific and technical consulting services:** CPC 8675;
3. Wholesale trade services: CPC 62271*;
4. **Retailing services:** CPC 63297*;
5. Engineering services, **Integrated engineering services**: CPC 8672+8673;
6. Management consulting service, Services related to management consulting: CPC 865+866;
7. Maintenance and repair of equipment: CPC 633, 8861-8866;
8. Technical testing and analysis services: CPC 8676;
9. Other construction services: CPC 518-Onstructon and decomposition of facilities;
10. Other construction services: CPC 511-518- construction and related engineering services;
11. **Services incidental to energy distribution:** CPC 887.

Among these services, bold faced sectors were not listed in the Azerbaijan's offer. This means that Azerbaijan has sought not to include energy related sectors, but there are other sectors where energy related services are included, although they are not as economically significant as the bold faced sectors.

# 4. Summary and Conclusion

As a general observation, the service sector offer of Azerbaijan is impressive. In order to objectively assess the level of services commitment, a scoring method was developed. Although such a method has many limitations, it gives us a broad picture over the commitments in the services by the WTO members. Overall level of commitments by Azerbaijan is quite higher than the average WTO members; Azerbaijan almost doubles the scores, according to the scoring method. However, it is also generally known in the WTO that the newly acceding members are requested by the incumbent members that a wider and deeper liberalization is required for the accession. Indeed, especially those newly acceding members in Central Asia and Europe, including Kyrgyz, Moldova and Ukraine, have made very liberal commitments. In this sense, high scores by Azerbaijan may not be impressive to the negotiators. Thus, a comparison with the newly acceding members was done, and it was found out that the level of commitment by Azerbaijan is not higher than the average of the newly acceding WTO members. This would

explain why the current accession negotiation in services did not proceed as expected.

In terms of sectoral coverage (number of sectors where commitments were made), Azerbaijan's offer in services is no different from those of newly acceding members. This means that Azerbaijan has covered a wide range of sectors while those listed sectors have relatively more restrictions compared to the newly acceding members. This is more significant in financial, construction, transportation, education and tourism services.

Despite these, overall, services sector negotiation did not seem to pose a major obstacle to the accession negotiation. From perspective of the author who has participated in the UR and DDA services sector negotiations, the current Azerbaijan's offer is rather ambitious. A wide range of sectors was listed, and entries for restrictions do not seriously inhibit trade in services. The services sector negotiators of Azerbaijan should be able to persuade negotiating partners how seriously they have scrutinized their regulatory systems and how much detailed and stepwise deregulation should take place before full liberalization can be committed, considering that Azerbaijan is still in transition after 70 years of being a planned economy.

## Annex 1 List of obligations under the Telecommunication Annex and the Reference Paper

| | Telecommunication Annex | Current Legislation | Comments |
|---|---|---|---|
| 3.b | Intra-corporate communications | Not defined | Resale or shared use? |
| 4 | Transparency | In general | Gazette- Public notice? |
| 5.a | Access to and use of PTTN/PTTS on reasonable and non-discriminatroy terms and conditions | In general | Principles... |
| 5.b(i) | Free attachment of terminal equipment | Not difined | Needs clarification |
| 5.b(ii) | Interconnection of leased circuits | Not clearly defined | Needs clarification |
| 5.b(iii) | Free choice of operationg protocols | Not difined | Need to guarantee |
| 5.c | Free movement of information | Not difined | Need to guarantee |
| 5.d | Security and confidentiality of information | Not clearly defined | Rights |
| 5.e(i) | Safeguard the public service responsibilities | - | Rights |
| 5.e(ii) | Protect technical integrity | - | Rights |
| 5.e(iii) | Prohibition of non-committed services | Not needed | Rights |
| 5.f(i) | Restriction on resale or share use | Not clearly defined | Rights |
| 5.f(ii) | Use of specified technical interface(protocols) | Not clearly defined | Rights |
| 5.f(iii) | Inter-operability | Not clearly defined | Rights |
| 5.f(iv) | Type approval | Not clearly defined | Rights |
| 5.f(v) | Restrictions on the interconnection of private leased lines | Not clearly defined | Rights |
| 5.f(vi) | Notification, registratin and licensing | Not clearly defined | Rights |

|  | Reference Paper | Current Legislation | Comments |
|---|---|---|---|
|  | Essential facilities | Not defined | Need definition, somehow |
|  | Major supplier | Not defined | Need definition |
| 1 | Competition safeguards | In general |  |
| 1.1(a) | Anti-competitive cross-subsidization | Not difined | Need provisions |
| 1.1(b) | Using information obtained from competitors | Not clearly defined | Needs provisions |
| 1.1(c) | Availability of information on a timely basis | Not clearly defined | Needs clarification |
| 2 | Interconnection | Not clearly defined | Need clarification |
| 2.2(a) | Non-discriminatory terms, no less favorable | Not clearly defined | Is this guaranteed? |
| 2.2(b) | Timely, cost-oriented, sufficiently unbundled | Not clearly defined | Is this guaranteed? |
| 2.2(c) | Charges that reflect the cost of constructions | Not clearly defined | Is this guaranteed? |
| 2.3 | Public availability of the procedures for interconnection negotiations | Not clear | Is this provided? |
| 2.4 | Transparency of interconnection arrangements | In principle | Need clarification |
| 2.5 | Interconnection: dispute settlement | Not clearly defined | Who has the jurisdiction? |
| 3 | Universal service: transparent, non-discriminatory, competition neutral | Not clearly defined | Need clarification |
| 4 | Public availability of licensing criteria | Not clearly defined | Is it fully known? |
| 5 | Independent regulators | Not clear | When to establish? |
|  | Legal authority and enforcement powers |  |  |
|  | Financial resources and autonomy |  |  |
|  | Knowledgeable but independent staff |  |  |
|  | For licensing, interconnection, leased lines, universal service, tariffs, numbering, frequencies, granting non-discriminatory use of rights of ways |  |  |
| 6 | Allocaiton and use of scarce resources, including frequencies | In principle | Is this guaranteed? |
|  | Notification, registration and licensing | Not clearly defined | Rights |

WTO Panel Decision (WT/DS 204)

## AGREEMENTS AT ISSUE

- The Annex on Telecommunications to the General Agreement on Trade in Services
- Reference Paper
- Mexico's Schedule of Specific Commitments

## U.S. CLAIMS AGAINST MEXICO

- Mexico has failed to comply with Section 2 of the Reference Paper which requires a major supplier to provide interconnection on "terms, conditions . . . and cost-oriented rates that are . . . reasonable."

- Mexico has not maintained appropriate measures to prevent Telmex, a major supplier, from engaging in "anti-competitive conduct" in accordance with Section 1 of the Reference Paper.

- Mexico has failed to ensure "access to and use of" its public telecommunications network and services, including private leased circuits, on "reasonable and non-discriminatory terms and conditions," in accordance with Section 5(a) of the Annex on Telecommunications.

- Mexico has failed to permit the use of leased lines in order to provide international service in violation of Section 5(b) of the Annex on Telecommunications.

- Mexico has failed to permit resale in violation of its Schedule of Specific Commitments.

## KEY FINDINGS

- "Interconnection" includes linking of a network in one country with the network of another country at the border so the Reference Paper obligations relating to interconnection apply to termination of international traffic at the border. Existence of the accounting rate system does not eliminate application of the interconnection obligations in the Reference Paper.

- "Mode 1" (cross-border supply of services) does NOT require a supplier to operate, or to

be present in some way, on both sides of the border.

- The “relevant market” for purposes of determining whether a supplier is a “major supplier” for purposes of the Reference Paper is defined by application of a “demand substitution” test.

- “Cost-oriented” means pricing based on the costs incurred in supplying the service, in this case the interconnection service. “Cost-oriented” does not equate exactly to cost, but should be founded on cost. Costs associated with the general state of the telecom industry or the coverage and quality of the network CANNOT be included in calculating interconnection costs.

- Prices for termination at the border that are 75% higher than costs for domestic termination are not “cost-oriented.” The fact that the international termination rates are consistent with benchmarks set by the ITU is not relevant to the analysis.

- “Reasonable” means “something of such an amount, size, number, etc., as is judged to be appropriate or suitable to the circumstances or purpose.”

- Prices for access to and use of the public telecommunications network must be reasonable. Prices that are “reasonable” for purposes of the Telecom Annex may be higher than rates that are cost-oriented in terms of the Reference Paper.

- Rates that exceed cost-based rates “by a substantial margin” and whose uniform nature exclude price competition do not provide “access to and use of “the public telecommunications network and services on “reasonable” terms.

- “Anti-competitive” practices include any action that lessens rivalry or competition in the market. The list in paragraph 1.2 of the Reference Paper is not exhaustive and other practices, such as price fixing and formation of cartels are covered by paragraph 1.2.

- The obligation to ensure access to and use of the public telecommunications network under the Annex on Telecommunications applies to foreign suppliers of any basic telecommunications services included in a WTO Member’s Schedule of Specific Commitments.

- Regulations required to make market access commitments effective should be in place at the time the commitments become effective or soon thereafter and at a minimum, the effort to draft and adopt such rules should be commenced by the time the commitment comes into force.

- Use of the phrase "facilities-based" in Mexico's Schedule of Specific Commitments means that Mexico has NOT agreed to permit provision of service through resale.

## LESSONS FOR REGULATORS

- Make sure that all regulations necessary to implement its commitments have been adopted by the time WTO obligations come into force or are in the process of being drafted.

- Require that interconnection rates for international and domestic termination charged by the major supplier are based on a costing methodology that only looks at the costs of providing the specific service and does not include costs associated with providing universal service or achieving other social goals.

- Make sure that charges for network components do not differ significantly based on whether they are used for domestic or international service.

- Allow new competitors to set prices for their services and freely negotiate commercial agreements for international and domestic services.

- Adopt measures to prevent a wide variety of anti-competitive conduct on the part of all market participants, including price-fixing, market-sharing arrangements and other cartel practices.

- Include a demand substitution test (the degree to which consumers would switch to other services) as part of an analysis of relevant markets.

- Adopt measures to ensure that new competitors have "access to and use of" the major supplier's network, including private leased circuits at rates that are not substantially higher than the major supplier charges for domestic interconnection.

- Permit resale of domestic and international facilities of the incumbent.

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# Chapter 02

# Analysis of Developing Country Status in the WTO System: Implication from the Korean Experience

1_ “Developing Country” in the WTO System
2_ “Developing Country” Status for Korea
3_ Policy Recommendation for Accession Negotiation
Annex

Chapter 02

# Analysis of Developing Country Status in the WTO System: Implication from the Korean Experience

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## 1. "Developing Country" in the WTO System

### 1.1. Overall Structures of Special and Differential Treatment for Developing Countries

The different types of special and differential treatment provisions included in various WTO Agreements operate in different ways. For instance, provisions relating to transition times and flexibility tend to specify exceptions to rules to which developing countries may have recourse if they choose. On the other hand, provisions relating to technical assistance, the safeguarding of interests of developing countries, and measures to increase developing countries' participation in world trade tend to specify positive actions to be undertaken by developed countries in favour of developing countries. In addition, individual WTO Agreements contain different types and combinations of special and differential treatment provision, reflecting, in part at least, their specific characteristics. For instance, agreements which require considerable investments in capacity for their implementation may also include provisions relating to technical assistance and transition time periods.

#### A. Provisions Aimed at Increasing the Trade Opportunities of Developing Country Members

There are fourteen such provisions in total across the following four agreements and one decision, namely:

(a) GATT 1994: Article XXXVI.2-5, Article XXXVII.1(a) and 4; Article XVIII.2 (c) and

2(e).

(b) The Enabling Clause, para 2(a).

(c) Agreement on Agriculture: Preamble.

(d) Agreement on Textiles and Clothing: **Article 2.18**

(e) GATS: Preamble, **Article IV:1; and Article IV:2**

These provisions all consist of actions to be taken by Members in order to increase the trade opportunities available to developing countries. Such provisions are frequently couched in "best endeavour" language, though not always. Provisions within this group which are mandatory (i.e. using "shall" rather than "should" language) are shown in bold above. Actions taken by members pursuant to some of these provisions are specifically notified to the Member this is the case for example with preferences given under the Enabling Clause, or actions taken under Article 2.18 of the Agreement on Textiles and Clothing by restraining Members. Members schedules of commitments under the GATS and concessions in the Agreement on Agriculture contain information relating to the implementation of these provisions. Overall, a broad question that seems to arise in relation to this class of provision concerns the extent to which these provisions have contributed to increasing developing countries' trade opportunities, how this may be assessed, and, if they have not contributed to the increasing developing countries' trade opportunities, what may be done.

### B. Provisions under which WTO Members should Safeguard the Interests of Developing Country Members

There are 47 such provisions across the following 13 WTO agreements and two decisions:

(a) Part IV of GATT 1994: Article XXXVI.6,7 and 9; Article XXXVII 1(b) and (c), 2-(a)-(c), 3 (a)-(c), and 5; Article XXXVIII.1, 2 (a), (b), (d), (f).

(b) The Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries: **Paragraphs 3 (i)-(ii); Paragraph 4; and Paragraph 5.**

(c) Application of SPS Measures: **Article 10.1** and Article 10.4.

(d) Textiles and Clothing: Article **6.6 (b), 6.6 (c)** and **Annex, paragraph 3(a).**

(e) Technical Barriers to Trade: **Article 10.6; Article 12.1; Article 12.2; Article 12.3; Article 12.5; Article 12.9; Article 12.10.**

(f) Implementation of Article VI of GATT 1994: **Article 15.**

(g) Implementation of Article VII of GATT 1994: **Annex III.5.**

(h) Decision on texts relating to minimum values and imports by sole agents, sole distributors, and sole concessionaires: **Text 1** and Text 2.

(i) Import Licensing Procedures: Article 1.2; Article 3.5 (a)(iv); Article 3.5 (j).

(j) Subsidies and Countervailing Measures: Article 27.1 and **Article 27.15.**

(k) Agreement on Safeguards: **Article 9.1 and Footnote 2.**

(l) Understanding on Rules and Procedures Governing the Settlement of Disputes: Article 4.10, **Article 8.10, Article 12.10, Article 12.11**; Article 21.2; **Article 21.7; Article 21.8.**

(m) GATS: Preamble; Article XII.1, **Article XV.1, and Article XIX.3.**

These provisions concern either actions to be taken by Members, or actions to be avoided by Members, so as to safeguard the interests of developing country Members. More than half of these are mandatory (i.e. they use “shall”, rather than “should”, language), and these are shaded in bold in the list presented above. Questions raised in relation to this category of provisions are similar to those raised in relation to the “trade opportunities” class. They turn around the extent to which they have led to the safeguarding of developing country interests, and whether the actions to be taken can be specified concretely, monitored and their implementation objectively measured or evaluated.

## C. Flexibility of Commitments, of Action, and use of Policy Instruments

There are 50 such provisions across the following ten different WTO agreements:

(a) GATT 1994: Article XVIII and Article XXXVI, paragraph 8.

(b) Enabling Clause: Paragraphs (b) and (c).

(c) The Agreement on Agriculture: Article 6.2; Article 6.4; Article 9.2(b)(iv); Article 9.4; Article 12.2; Article 15.1; Annex 2, para 3, and footnote5; Annex 2, para.4, footnotes 5 and 6; Annex 5, Section B.

(d) Technical Barriers to Trade: Article 12.4.

(e) Trade-Related Investment Measures: Article 4.

(f) Subsidies and Countervailing Measures: Article 27.2 (a) and Annex VII; Article 27.4; Article 27.7; Article 27.8; Article 27.9; Article 27.10; Article 27.11; Article 27.12; Article 27.13.

(g) Safeguards :Article 9.2.

(h) GATS: Article III:4;Article V:3; Article xix:2, and Paragraph 5(g) of the Annex on telecommunications.

(i) Understanding on Rules and Procedures Governing the Settlement of Disputes: Article 3.12.

These provisions relate to: actions developing countries may undertake through exemptions from disciplines otherwise applying to the membership in general; exemptions from commitments otherwise applying to Members in general; or a reduced level of commitments developing countries may choose to undertake when compared to Members in general. The majority of these provisions are found in agreements concluded at the end of the Uruguay Round. Their importance may be understood in terms of their actual or potential role in facilitating the integration of trade and trade policy into the pursuit of wider development policy objectives. This type of provision is especially prominent, and important, in those areas and

agreements where WTO rules have extended beyond traditional GATT-type border measures. In almost all cases, flexibility takes the form of individual provisions which Members choose, or not, to exercise. The main exception is the GATS, where in addition to individual provisions, flexibility is built into the overall structure of the agreements which provides for flexibility on an individual- case-by-case basis through negotiated commitments.

## D. Transitional Time Periods

There are 19 such provisions across the following eight agreements:

(a) Agriculture: Article 15.2.

(b) Sanitary and Phytosanitary Measures: Article 10.2 and 10.3.

(c) Technical Barriers to Trade: Article 12.8.

(d) Trade-Related Investment Measures: Article 5.2.

(e) Implementation of Article VII of GATT 1994: Article 20.1; Article 20.2; Annex?III.1; and Annex III.2

(f) Import Licensing Procedures: Article 2.2, footnote 5.

(g) Subsidies and Countervailing Measures: Article 27.2 (b); Article 27.4; Article 27.14; Article 27.5; Article 27.6; and Article 27.11.

(h) TRIPS: Article 65.2; and 65.4.

These provisions relate to time bound exemptions from disciplines otherwise generally applicable.[1] It is to be noted that some transition time periods in different agreements have elapsed. In some cases, the relevant provision, in addition to specifying a time-period, include modalities through which an extension might be sought. Transition time periods were an innovation of the Uruguay Round. They reflect the recognition that the process of implementation of WTO agreements, and accompanying reforms, could give rise to transitional costs. It is possible to distinguish between two different types of costs: first, those which stem from the fact that the implementation of certain WTO agreements requires significant levels of human and institutional capacity. The second type of cost - the political economy- adjustment type - for example, transitional shifts in output and employment in specific sectors which may result from the phasing out of protection. The type of cost which may arise is specific to individual agreements, and the magnitude of the cost may depend on individual country circumstances.

1. In the case article 10.2 of the SPS agreement, the transition time-period in question relates to longer time-frames for compliance to be accorded to products of interest to developing countries with SPS measures introduced by Members.

## E. Technical Assistance

There are 14 such provisions across the following six different agreements and one ministerial decision:

(a) Decision on measures concerning the possible negative effects of the reform programme on least-developed countries and net-food importing developing countries: Paragraph 3 (iii).

(b) Application of SPS Measures: Articles 9.

(c) Technical Barriers to Trade: Article 11.1; Article 11.1; Article 11.3; Article 11.4; Article 11.5; Article 11.6; and Article 12.7.

(d) Implementation of Article VII of GATT 1994: Article 20.3.

(e) GATS: Article XXV:2 and Paragraph 6 of the Annex on telecommunications.

(f) TRIPS: Article 67.

(g) Understanding on Rules and Procedures Governing the Settlement of Disputes: Article 27.2.

The agreements where provisions relating to technical cooperation feature prominently tend to be those which require significant levels of capacity for their implementation. The provision of technical assistance can thus be closely linked with transition time periods in facilitating the implementation of certain WTO agreements.

## F. Provisions Relating to Least-Developed Country Members

There are 24 such provisions across seven agreements and three decisions:

(a) Agriculture: Article 15.2, Article 16.1 and Article 16.2.

(b) Enabling Clause: Paragraph d. 1.

(c) Decision on waiver for preferential tariff treatment of Least-Developed Countries.

(d) Textiles and Clothing: Footnote to Article 1.2, and Article 6.6 (a).

(e) Technical Barriers to Trade: 11.8.

(f) Trade-Related Investment Measures Article 5.2.

(g) GATS: Article IV:3, and Article XIX:3.

(h) TRIPS: Article 66.1 and 66.2.

(i) Understanding on Rules and Procedures Governing the Settlement of Disputes: Article 24.1 and 24.2.

(j) Decision on Measures in Favour of Least-Developed Countries: paragraphs 1-3.

These provisions, whose applicability is limited exclusively to the LDCs, all fall under one of the other five types of provisions, as follows:

(a) Six fall into the category of provisions aimed at increasing trade opportunities:

- Enabling Clause - paragraph d.

- Decision on waiver for preferential tariff treatment of LDCs.
- Agreement on Textiles and Clothing - Footnote to Article 1.2.
- TRIPS Agreement -Article 66.2.
- Decision on Measures in Favour of Least-Developed Countries - paragraph 2 (ii) and paragraph 3.

(b) Ten fall into the category of provisions aimed at safeguarding the interests of least-developed countries:

- Agreement on Agriculture - Article 16.1 and 16.2.
- Agreement on Textiles and Clothing - Article 6.6 (a).
- GATS - Article IV:3 and XIX:3.
- Understanding on Rules and Procedures Governing the Settlement of Disputes: Article 24.1 and 24.
- Decision on Measures in Favour of Least-Developed Countries: paragraphs, 2(i), 2(iii) and 2(iv).

(c) One relating to the flexibility of commitments, of action, and use of policy instruments - Article 15.2 of the Agreement on Agriculture.

(d) Three in the category of transition time periods:

- TRIMS - Article 5.2.
- TRIPS - Article 66.1.
- Decision on Measures in Favour of Least-Developed Countries paragraph 1.

(e) Two in the category of technical assistance:

- Technical barriers to trade - Article 5.8
- Decision on Measures in Favour of Least-Developed Countries - Paragraph 2(v).

## 1.2. Provisions Aimed at Increasing the Trade Opportunities of Developing Country Members

### A. Implementation of Article VI of the GATT 1994, Article 15

*"It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members."*

This provision can be classified as an **obligation of conduct**. The provision requires that, in certain circumstances, "special regard" be given to the situation of developing country Members and that constructive remedies be "explored". No specific result is envisaged. This provision also stipulates an **obligation of Members taken individually**.

The Panel in *European Communities - Antidumping Duties on Imports of Cotton-Type Bed Linen from India* rule that the European Communities had failed to act consistently with the obligations imposed by Article 15 of the Antidumping Agreement. In its findings, the Panel noted that: (i) Article 15 referred to "remedies" in respect of injurious dumping. A decision not to impose an anti-dumping duty was not a remedy of any type, constructive or otherwise; (ii) Imposition of a lesser duty or a price undertaking would constitute "constructive remedies" within the meaning of Article 15. The Panel did not come to a conclusion as to what other actions might in addition constitute "constructive remedies" Article 15; (iii) The phrase "before applying anti-dumping duties" in Article 15 means before the application of definitive antidumping duties; and (iv) Article 15 imposes no obligation to actually provide or accept any constructive remedy that may be identified and/or offered. The Panel concluded that Article 15 does, however, impose an obligation to actively consider, with an open mind, the possibility of such a remedy prior to the imposition of an anti-dumping measure that would affect the essential interests of a developing country.[2] The Dispute Settlement Body adopted the report of the Panel as modified by the Appellate Body (which did not consider this aspect of the Panel's report) on 12 March 2001. On 7 August 2001 the EC suspended the application of the anti-dumping measure with regard to imports originating in India, effective 14 August 2001. The EC considers that by this action, it has fully implemented the DSB recommendations and rulings. India has made known to the EC that it is in disagreement as to whether this action constitutes full implementation of the DSB recommendations and rulings in the dispute.[3]

In discussions on this provision in the Committee on Anti-Dumping Practices, Members have expressed the view that developed Members have not complied with Article 15 when imposing anti-dumping duties.[4]

This issue is also part of the work to be done in WTO subsidiary bodies pursuant to paragraph 7.2 of the Doha Decision of 14 November 2001 on Implementation-Related Issues and Concerns (WT/MIN(01)/17). In this Decision, Ministers recognize "that, while Article 15 of the Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 is a mandatory provision, the modalities for its application would benefit from clarification." Pursuant to this decision, "the Committee on Anti-Dumping Practices is instructed, through its working group on Implementation, to examine this issue and to draw up appropriate recommendations within twelve months (that is by 14 November 2002) on how to operationalize this provision".

2. WT/DS/141R, dated 30 October 2000.
3. WT/DS141/11, dated 21 September 2001.
4. G/ADP/W/416 dated 8 November 2000, G/ADP/M/15 dated 14 March 2000, G/ADP/M/16 dated 20 September 2000, G/ADP/M/17 dated 9 April 2001, G/ADP/M/18 dated 21 November, 2001.

### B. Agreement on Subsidies and Countervailing Measures, Article 27.15

*"The Committee **shall**, upon request by an interested developing country Member, undertake a review of a specific countervailing measure to examine whether it is consistent with the provisions of paragraphs 10 and 11 as applicable to the developing country Member in question."*

This provision can be classified as an **obligation of result** insofar as it requires the relevant Committee to initiate and carry out a review of a CVD measure, if so requested. This provision also stipulates an **obligation of Members taken collectively** since the Committee is instructed to undertake a review.

To date no request has been received by the SCM Committee pursuant to Article 27.15 (that is, to review a specific countervailing measure). This issue is also part of the work to be done in WTO subsidiary bodies pursuant to the paragraph 10.3 of the Decision adopted 14 November 2001 on Implementation-Related Issues and Concerns (WT/MIN(01)/17), addressing specific existing special and differential treatment provisions. In this Decision, Ministers agreed that the Committee on Subsidies and Countervailing Measures continue its review of the provisions of the Agreement on Subsidies and Countervailing Measures regarding countervailing duty investigations and report to the General Council by 31 July 2002. This Decision covers all provisions of the SCM Agreement having to do with countervailing duty investigations. To date, no Member has submitted a proposal concerning Article 27.15 in the context of this review.

### C. Agreement on Safeguards, Article 9.1

*"Safeguard measures **shall not be applied** against a product originating in a developing country Member as long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent, provided that developing country Members with less than 3 per cent import share collectively account for not more than 9 per cent of total imports of the products concerned 2."*

Footnote 2: *"A Member **shall immediately notify** an action under paragraph 1 of Article 9 to the Committee on Safeguards."*

This provision can be classified as an **obligation of result** given that, subject to certain conditions, it prevents Members from applying safeguard measures against products from certain developing country Members. It also prescribes the notification of any safeguard measures that may nevertheless be taken. This provision also stipulates an **obligation of Members taken individually** since individual Members take safeguard measures.

This provision is invoked generally when a safeguard measure is conducted.

## D. Understanding on Rules and Procedures Governing the Settlement of Disputes, Article 8.10

*"When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests,* ***include*** *at least one panelist from a developing country Member."*

This provision can be classified as an **obligation of result,** as it requires the inclusion of at least one panelist from a developing country Member, if a request is made. This provision also stipulates an **obligation of Members taken individually** insofar as a developed country Member cannot object to the inclusion of a panelist on the grounds that the person is from a developing country Member.

In disputes between developing country Members and developed country Members, nationals of developing country Members regularly serve as panelists. This has been the result of specific requests from developing country Members pursuant to this provision.

## E. Understanding on Rules and Procedures Governing the Settlement of Disputes, Article 12.10

*"In the context of consultations involving a measure taken by a developing country member, the parties may agree to extend the periods established in paragraphs 7 and 8 of Article 4. If, after the relevant period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB* ***shall decide****, after consultation with the parties, whether to extend the relevant period and, if so, for how long."*
*"In addition, in examining a complaint against a developing country Member, the panel* ***shall accord*** *sufficient time for the developing country Member to prepare and present its argumentation. The provisions of paragraph 1 of Article 20 and paragraph 4 of Article 21 are not affected by any action pursuant to this paragraph."*

This first part of this provision can be classified as an obligation of result since it requires the Chairman of the DSB to make a decision. The second part of the provision can be classified as an obligation of result, in that it requires panels to grant sufficient time to developing country respondents to prepare and present their argumentation.

In one dispute, a developing country defendant contended that the process raised a number of questions in relation to the DSU such as (i) the real difficulties faced by developing countries on the insistence by a developed country that consultations be held only in Geneva; (ii) the

meaning and significance of the consultations stage; (iii) whether a Member could decide unilaterally that consultations had been concluded in particular since Article 12.10 of the DSU provided that "In the context of consultations involving a measure taken by a developing country Member, the parties may agree to extend the period established in paragraph 7 and 8 of the Article 4. If, after the relevant period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB shall decide, after consultations with the parties, whether to extend the relevant period, and if so, for how long." For all these reasons, the developing country Member could not agree to the establishment of a panel requested by a developed country Member.[5]

## F. Understanding on Rules and Procedures Governing the Settlement of Disputes, Article 12.11

*"Where one or more of the parties is a developing country Member, the panel's report* ***shall explicitly indicate*** *the form in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members that form part of the covered agreements which have been raised by the developing country Member in the course of the dispute settlement procedures."*

This provision can be classified as an obligation of result since it requires panels to indicate in their reports how special and differential treatment provisions have been taken into account of.[6]

## G. Understanding on Rules and Procedures Governing the Settlement of Disputes, Article 21.7

*"If the matter is one which has been raised by a developing country Member, the DSB* ***shall consider*** *what* ***further action*** *it might take which would be appropriate to the circumstances."*

This provision can be classified as an **obligation of conduct** if it is understood to mean that the DSB is not required to take specific further action, but rather to "think" about and discuss what, if any, further action might be taken. This provision also stipulates an **obligation of Members taken collectively** since the obligation is laid on the DSB.

5. WT/DSB/M/21, dated 5 August 1996, p. 4.
6. Panel reports show that this provision has been taken into account of. Examples can be found in document WT/DS/141/R (*EC - Bed Linen*) dated 15 May 2000, or document WT/DS/90/R (*India - Quantitative Restrictions*) dated 6 April 1999.

## H. Understanding on Rules and Procedures Governing the Settlement of Disputes, Article 21.8

*"If the case is one brought by a developing country Member, in considering what appropriate action might be taken, the DSB shall take into account not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned."*

This provision can be classified as an **obligation of conduct**. The provision does not prescribe specific action to be taken, but rather requires the DSB to "take into account" certain aspects in considering specific action. This provision also stipulates an **obligation of Members taken collectively** since the DSB is the addressee of the obligation.

This provision has been taken into account in an arbitrator's decision pursuant to Article 22.7 of the DSU.[7]

## I. General Agreement on Trade in Services, Subsidies, Article XV.1

*"Members recognise that, in certain circumstances, subsidies may have distortive effects on trade in services. Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects.[7] The negotiations shall also address the appropriateness of countervailing procedures. Such negotiations shall also recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area. For the purpose of such negotiations, Members shall exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers."*
*Footnote [7]: "A future work programme shall determine how, and in what time-frame, negotiations on such multilateral disciplines will be conducted."*

The classification of this provision presents some difficulty. The provision could be considered an obligation of conduct if it is understood to mean that the mandated negotiations must "recognize" the development role of subsidies and "take account" of the needs of developing countries for flexibility, without, however, predetermining a specific result. If, on the other hand, the provision is understood to mandate some flexibility for developing country Members, it could be classified as an obligation of result. This provision also stipulates an

7_ Document WT/DS27/ARB/ECU (*EC - BananasIII(Ecuador) (Article 22.6 - EC)*).

obligation of Members taken collectively in view of the fact that the envisaged negotiations are multilateral in nature.

## J. General Agreement on Trade in Services, Negotiations on Specific Commitments, Article XIX.3

*"For each round, negotiating guidelines and procedures shall be established. For the purposes of establishing such guidelines, the Council for Trade in Services shall carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement, including those set out in paragraph 1 of Article IV. Negotiating guidelines shall establish modalities for the treatment of liberalization undertaken autonomously by Members since previous negotiations, as well as for the special treatment for least-developed country Members under the provisions of paragraph 3 of Article IV"*

This provision can be classified as an **obligation of result**. It prescribes for that negotiating guidelines and modalities be established for the treatment of liberalisation undertaken autonomously. Section V.B.3 below refers to Article IV.3 on least-developed countries. It is not entirely clear whether this provision stipulates an **obligation of Members taken collectively** and/or of **Members taken individually**. The provision could be seen as directed both at Members engaged in multilateral negations and at Members engaged in bilateral negotiations.

Guidelines and Procedures for the Negotiations on Trade in Services were adopted by the Special Session of the Council for Trade in Services on 28 March 2001, pursuant to the objectives of the GATS, as stipulated in the Preamble and Article IV, and as required by Article XIX.[8] Section III of "Modalities and Procedures", paragraph 13 addresses requirements specific to this provision stating, "Based on multilaterally agreed criteria, account shall be taken and credit shall be given in the negotiations for autonomous liberalization undertaken by Members since previous negotiations. Members shall endeavour to develop such criteria prior to the start of negotiation of specific commitments."

During a Special Session of the Services Council, several developing countries made submissions with regard to the treatment of autonomous liberalization in the WTO service negotiations.[9]

8. Document S/L/93 dated 29 March 2001.
9. Documents S/CSS/W/126 and 130 dated 30 November 2001.

## A. Measures to enhance trade opportunities for developing country Members

| Instrument | Measures | In Favour of/Concerning | Article |
| --- | --- | --- | --- |
| Agreement on Textiles and Clothing | More favourable growth factor | Small exporters, new entrants and to the extent possible LLDCs | 1:2<br>2:18 |
| | Consideration of particular interests | Cotton producing exporting Members | 1:4 |
| Agreement on Technical Barriers to Trade (TBT) | Examination by international standardizing bodies of the possibility of preparing international standards (upon request) | Products of special interest to LDCs | 12:6 |
| General Agreement on Trade in Services (GATS) | Negotiation of specific commitments | Services sectors and modes of supply of export interest to LDCs, in particular LLDCs | IV:1 |
| Decision on Measures in Favour of LLDCs | Autonomous implementation, in advance and without staging, of Uruguay Round concessions on tariffs and non-tariff measures | Products of export interest to LLDCs | 2(ii) |
| | Consideration of improving preferential treatment | Products of export interest to LLDCs | 2(ii) |
| | Adoption of positive measures which facilitate the expansion of trading opportunities | LLDCs | 3 |

## B. Measures safeguarding developing country Members' interests, to be implemented domestically

| Instrument | Measures | In Favour of/Concerning | Article |
| --- | --- | --- | --- |
| Agreement on Sanitary and Phytosanitary Measures (SPS) | Consideration of special needs in the preparation and application of SPS measures | LDCs, and in particular of the LLDCs | 10:1 |
| | Longer time-frames for compliance with new SPS measures | Products of interest to LDCs | 10:2 |

| | | | |
|---|---|---|---|
| | Allow a reasonable interval between the publication and entry into force of a SPS regulation | In particular, producers of LDCs | Annex B, para. 2 |
| Agreement on Textiles and Clothing | Consideration of particular interests | Cotton producing exporting Members | 1:4 |
| | Significantly more favourable treatment regarding the transitional safeguard | LLDCs | 6:6(a) |
| | More favourable treatment regarding the application of quota levels, growth rates and flexibility in the transitional safeguard | Small suppliers, new entrants and to the extent possible also LLDCs | 1:2<br>6:6(b) |
| | Special consideration of needs in the application of quota levels, growth rates and flexibility in the transitional safeguard | Comparatively small textiles and clothing exporters dependent on the wool sector | 6:6(c) |
| | More favourable treatment regarding the transitional safeguard | Exports of Members having a significant portion of their exports in outward processing trade | 6:6(d) |
| | No transitional safeguard | Exports of handloom fabrics from LDCs and other specific products of export interest to LDCs | Annex, para. 3 |
| TBT Agreement | Allow a reasonable interval between the publication and entry into force of a technical regulation and requirements concerning conformity assessment procedures | In particular, producers of | 2:12<br>5:9 |
| | Consideration of special needs in the implementation and operation of the Agreement;  and  in the preparation and application of technical regulations, standards and conformity assessment procedures | LDCs | 12:2<br>12:3<br>12:9 |
| Agreement on Anti-Dumping | Special regard of special situation in considering the application of anti-dumping measures | LDCs | 15 |
| | Exploring constructive remedies before applying anti-dumping duties | Products of essential interest of LDCs | 15 |

| Instrument | Measures | In Favour of/Concerning | Article |
|---|---|---|---|
| Agreement on Import Licensing Procedures | Consideration of needs to preventing trade distortions arising from an inappropriate operation of administrative procedures used to implement import licensing régimes | LDCs | 1:2 |
| | Better treatment in allocating licences among importers | Products from LDCs, in particular LLDCs | 3:5(j) |
| Agreement on Subsidies and Countervailing Measures | Positive demonstration that Article 6:1 subsidies caused serious prejudice | Subsidies granted by LDCs | 27:8 |
| | Application of defined threshold for classifying the volume of subsidized imports as negligible | Subsidized imports from LDCs | 27:10 |
| | More favourable threshold for classifying the level of subsidization as de minimis | Subsidized imports from LDCs | 27:10<br>27:11 |
| | No actionability under multilateral rules of direct forgiveness of debt and certain other subsidies in the context of a privatization programme | Subsidies granted by LDCs | 27:13 |
| Agreement on Safeguards | Exemption from safeguard measures provided they remain below a certain threshold | Imports from LDCs | 9:1 |
| GATS | Establishment of contact points to facilitate the access to information relating to Members' markets | Service suppliers of LDCs, in particular LLDCs | IV:2 |
| Dispute Settlement Understanding (DSU) | Special attention to particular problems and interests during consultations | LDCs | 4:10 |
| | Due restraint in using the dispute settlement mechanism | Measures taken by LLDC | 24:1 |
| Decision on Measures in Favour of LLDCs | Special consideration of export interests when applying import restrictions | LLDCs | 2(iv) |

## C. Measures safeguarding developing country Members' interests, to be implemented multilaterally

| Instrument | Measures | In Favour of/ Concerning | Article |
|---|---|---|---|
| WTO Agreement | Periodical review of the special provisions and propose action | LLDCs | IV:7 |
| Agreement on Agriculture | Consideration of special and differential treatment in the negotiations for continuing the reform in agricultural trade | LDCs | 20(c) |
| TBT Agreement | Consideration of special needs in the implementation and operation of the Agreement | LDCs | 12:2 |
| | Facilitation of participation in international standardizing bodies and international systems for conformity assessment | Relevant bodies in LDCs | 12:5 |
| | Periodical examination of the special and differential treatment | LDCs | 12:10 |
| Agreement on Subsidies and Countervailing Measures | More favourable dispute resolution during the transition period | Export subsidies and subsidies contingent upon the use of domestic over imported goods granted by LDCs | 27:7 |
| | Limitations on actionability | Subsidized products from LDCs | 27:9 |
| | Review of the consistency of a Member's countervailing measure with special and differential treatment (upon request) | LDCs | 27:15 |
| GATS | Consideration of needs when disciplines concerning subsidies will be developed | LDCs | XV:1 |
| | Inclusion of special treatment in guidelines for future trade liberalizing rounds | LLDCs | XIX:3 |
| DSU | Inclusion of at least one panellist from a LDC in the panel (upon request) | Disputes between a LDC and a developed country Member | 8:10 |
| | Possible extension of periods for consultations, agreed by parties or | Disputes involving a measure taken by a LDC | 12:10 |

| Instrument | Measures | In Favour of/Concerning | Article |
|---|---|---|---|
| | decided by Chairman of Dispute Settlement Body | | |
| | Accord sufficient time to prepare and present argumentation before the panel | LDCs when defendant party | 12:10 |
| | Explicit indication in the panel report of how special and differential provisions raised were considered | Disputes where one or more members is a LDC | 12:11 |
| | Particular attention in the surveillance of the implementation of recommendations or rulings | Matters affecting the interests of LDCs | 21:2 |
| | Consideration of what further action might be taken | Case brought by a LDC | 21:7<br>21:8 |
| | Particular consideration to the special situation at all stages of the dispute | Disputes involving a measure taken by a LLDC | 24:1 |
| Decision on Measures in Favour of LLDCs | Regular reviews for ensuring expeditious implementation of all special and differential measures | LLDCs | 2(i) |
| Decision Relating to LLDCs and Net Food-Importing Developing Countries (NFICs) | Periodical review of the level of food aid | LLDCs and NFICs | 3(i) |
| | Establishing a level of food aid commitments sufficient to meet legitimate needs during the reform programme | LDCs | 3(i) |
| | Adoption of guidelines for ensuring that an increasing proportion of basic foodstuffs is provided | LLDCs and NFICs | 3(ii) |
| | Ensuring that any agreement relating to agricultural export credits makes appropriate provision for differential treatment | LLDCs and NFICs | 4 |
| | Possibility of drawing on the resources of international financial institutions in cases of short-term difficulties in financing normal levels of commercial imports | LLDCs and NFICs | 5 |

# 1.3. Monitoring Mechanism/Processes on Special and Differential Treatment

## A. Subsidiary Bodies of the General Council

### (1) Council for Trade-Related Aspects of Intellectual Property Rights

(i) Technical cooperation for developing countries pursuant to Article 67 of the TRIPS Agreement

Article 67 of the TRIPS Agreement requires developed country Members to provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and LDC Members. According to this provision, the objective of such cooperation is to facilitate the implementation of the Agreement. Article 67 specifies that such assistance shall include assistance in the preparation of laws and regulations on the protection and enforcement of intellectual property rights as well as on the prevention of their abuse, and support regarding the establishment or reinforcement of domestic offices and agencies relevant to these matters, including the training of personnel.

Technical cooperation pursuant to Article 67 of the TRIPS Agreement is a regular item on the agenda of the TRIPS Council's meetings, with a view to monitoring compliance with the obligation contained in Article 67, sharing information on the technical cooperation possibilities available and providing an opportunity to identify any needs not adequately being addressed.

In order to ensure that information on available assistance is readily accessible and to facilitate the monitoring of compliance with the obligation of Article 67, developed country Members annually present descriptions of their relevant technical and financial cooperation programmes. The information received is reviewed each year by the TRIPS Council at a meeting normally held in the autumn. For the sake of transparency, intergovernmental organizations with observer status in the TRIPS Council, such as World Intellectual Property Organisation and the World Health Organization, have also annually presented, on the invitation of the Council, information on their activities. In addition, the WTO Secretariat reports on its technical cooperation activities in the TRIPS area.[10]

The TRIPS Council has agreed that each developed country Member should notify a contact point for technical cooperation on TRIPS, in particular for the exchange of information between

10. This information from developed country Members, intergovernmental organizations and the WTO Secretariat on their technical cooperation activities in the area of TRIPS is circulated in IP/C/W/- series of documents.

donors and recipients of technical assistance.[11]

(ii) TRIPS and Public Health

On 30 August 2003, the General Council adopted a decision on "Implementation of Paragraph 6 of the Doha Declaration on the TRIPS Agreement and Public Health".[12] The decision contains a set of three waivers from certain provisions of the TRIPS Agreement.

Although the decision does not specifically relate to a S&D provision, the purpose of the decision is to facilitate affordable access to medicines in countries with insufficient or no manufacturing capacities in the pharmaceutical sector and that all developed countries have opted out from using the system created under it for importation of medicines. To this extent, it is a special and differential decision and it does contain some provisions dealing specifically with review and monitoring.

Paragraph 8 of the decision provides that the Council for TRIPS shall annually review the functioning of the system set out in the decision with a view to ensuring its effective operation and report annually on its operation to the General Council. This review shall be deemed to fulfil the review requirements of Article IX:4 of the WTO Agreement. The first annual review was held at the TRIPS Council's meeting in December 2004.

On 6 December 2005, the General Council adopted a decision on "Amendment of the TRIPS Agreement",[13] which will make the system created under the 2003 waiver decision a permanent part of the TRIPS Agreement. The waiver decision will remain in force for each Member until the amendment replacing its provisions takes effect for that Member. Paragraph 7 of the Annex to the TRIPS Agreement contained in the Protocol Amending the TRIPS Agreement provides for a similar annual review of the functioning of the system.

### (2) Committee on Trade and Development

(i) Technical Assistance

The Committee on Trade and Development (CTD) is mandated to provide guidelines for, and to review periodically, the technical cooperation activities of the WTO as they relate to developing country Members. In addition to formally approving the WTO's Technical Assistance and Training Plans[14], the CTD also considers, on a yearly basis, a semi-annual

11. These notifications are being circulated in IP/N/7- series of documents, which are available on the WTO Document Online database.
12. WT/L/540 and Corr.1.
13. WT/L/641.
14. Biennial Technical Assistance and Training Plan 2008 - 2009 contained in WT/COMTD/W/160.

review and an annual report on the implementation of technical assistance activities[15], as well as the annual technical cooperation audit report.[16]

(ii) Duty-Free Quota-Free Market Access Decision

At the Hong Kong Ministerial Conference Ministers adopted a decision calling on developed countries and developing country Members in a position to do so, to provide dutyfree quotafree (DFQF) market access for goods originating from LDCs.[17] As part of this decision, it was agreed that Members should notify, annually, the implementation of the schemes adopted under the decision to the CTD which would in turn carry out an annual review of the steps taken to provide DFQF market access to the LDCs and report to the General Council for appropriate action. Since the Hong Kong Ministerial Conference, the CTD has been considering the steps taken to provide DFQF market access to LDCs.[18]

(iii) Notifications under the Enabling Clause

The 1979 GATT Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries - known as the "Enabling Clause" - provides the legal basis for the notification of certain types of preferential trade arrangements in the WTO, including regional trade agreements (RTAs) in goods between developing countries as well as the GSP schemes of many developed countries. Notifications under the Enabling Clause are considered in the CTD. Based on Members' desire to enhance the transparency of information concerning RTAs, the General Council took a decision on 14 December 2006 to establish, on a provisional basis, a Transparency Mechanism for RTAs. The Transparency Mechanism applies to all RTAs notified to the WTO, including those notified under the Enabling Clause. Also on 14 December 2006, the General Council invited the CTD to consider transparency for preferential arrangements under the Enabling Clause other than those covered by the Transparency Mechanism for RTAs.

(iv) Aid For Trade

The WTO plays a key role in monitoring and evaluating progress on Aid for Trade, through periodic reviews in the CTD, and an annual Global Review on Aid for Trade in the General Council, which draws together the various tiers of monitoring inputs into a coherent picture. The OECD and the WTO have collaborated closely in setting up an aid-for-trade monitoring framework. This framework aims to elicit critical quantitative and qualitative information from donor agencies, and their partner countries to provide a comprehensive picture of aid for trade and allow the international community to assess what is happening, what is not, and where

15. The most recent reports are contained in WT/COMTD/W/161 and WT/COMTD/W/157 respectively.
16. WT/COMTD/W/158.
17. Annex F of WT/MIN(05)/DEC.
18. See Minutes WT/COMTD/M/57 - M/59, M/61 - M/65, and M/67 (to be issued).

improvements are needed.

The first tier provides a global picture of annual aid-for-trade flows based on statistical data from the OECD/Development Assistance Committee (DAC) Creditor Reporting System (CRS) database. Data on global flows are clearly important in assessing whether additional resources have been made available, in helping identify where funding gaps remain, in highlighting where resource reallocation might be appropriate, and in increasing transparency on pledges and disbursements. The second tier relies on donor self-evaluation. In seeking specific inputs from donors, this level of reporting allows for refining the quantifications of aid for trade derived from the CRS database. In addition, this second tier of monitoring also aims to uncover qualitative information on best practices and how, in the case of aid for trade, donors adhere to the principles of the Paris Declaration on Aid Effectiveness. The third tier relies on self-assessments provided by partner countries. This tier allows partner countries to define which activities in their national development strategies are identified as trade development priorities. As such, it permits partner countries to refine the quantification of aid for trade and elicits additional qualitative information on how partner countries adhere to the principles of the Paris Declaration on Aid Effectiveness.

In addition, monitoring is also carried out through reviews of aid-for-trade activities, held at the regional level. The Regional reviews provide a platform for donors to explain their regional strategies and commitments, and for partner countries to identify key gaps and priorities.

### (3) Committee on Regional Trade Agreements

Under the provisional Transparency Mechanism on RTAs that was adopted by the General Council in December 2006, the Secretariat prepares factual presentations on all RTAs relating to goods and/or services that are notified to it, including those RTAs notified under the Enabling Clause. As of January 2008, 11 RTAs have been considered and the Committee has begun its 'initial review' of the Transparency Mechanism as required by the General Council Decision.

### (4) Committee on Balance-of-Payments Restrictions

While there is no monitoring mechanism in place or under discussion in the Committee on Balance-of-Payments Restrictions, consultations held under Article XVIII:B of the GATT relating to quantitative restrictions for balance-of-payment purposes, can be considered to contain an implicit monitoring in that Members are to review all restrictions still applied under Section B of Article XVIII. Subsequently, those Members applying the restrictions, are to enter into consultations along specific guidelines in order to determine whether the restrictions are consistent with the rules or whether there is a need to modify them.

## B. Subsidiary Bodies of the Council for Trade in Goods

### (1) Committee on Agriculture

In accordance with Article 18 of the Agreement on Agriculture, the Committee on Agriculture carries out the review of the implementation of all Members' commitments as set out under the Agreement and embodied in the Schedules of Concessions. There is no specific and separate review of S&D provisions in favour of developing country Members.

### (2) Committee on Sanitary and Phytosanitary Measures

While the Committee on Sanitary and Phytosanitary Measures does not have a monitoring mechanism specifically to review the implementation of S&D provisions, the implementation of S&D is a standing item on the Committee's agenda. In addition, the Committee has in place a mechanism to ensure transparency of S&D provided in response to requests by developing countries.[19] The Committee also has in place a mechanism to address any specific trade concerns related to sanitary and phytosanitary measures raised by any Member.

### (3) Committee on Technical Barriers to Trade

Article 12 of the Agreement on Technical Barriers to Trade (TBT Agreement) contains specific provisions on S&D for developing country Members. Paragraph 10 of Article 12 instructs the Committee to carry out periodic examinations of special and differential treatment as laid down in the TBT Agreement that is granted to developing country Members on national and international levels.

The Committee's First Triennial Review resulted in a number of recommendations, including inviting Members to voluntarily exchange information on the implementation of Article 12 of the TBT Agreement.[20] In its Fourth Triennial Review Report adopted in November 2006[21], the Committee agreed "to encourage Members to inform the Committee of special and differential treatment provided to developing country Members, including information on how they have taken into account special and differential treatment provisions in the preparation of technical regulations and conformity assessment procedures", and to "encourage developingcountry Members to undertake their own assessments of the utility and benefits of such special and differential treatment".

19. G/SPS/33 and Add.1.
20. G/TBT/5.
21. G/TBT/19.

### (4) Committee on Anti-Dumping Practices

Article 15 of the Anti-Dumping Agreement requires developed country Members, before applying antidumping duties on products of developing Members, to "explore possibilities of constructive remedies" where the duties would "affect the essential interests" of the developing country Member.

Pursuant to the Doha Ministerial Decision on Implementation-Related Issues and Concerns [22], which calls upon the Committee on Anti-Dumping Practises to develop guidelines for improving its annual reviews of the operation of the Agreement, the Committee adopted recommendations relating to its annual reporting to the Goods Council.[23] The recommendations include the need for developed country Members, in their biannual reports of antidumping actions taken, to report on how they have fulfilled the obligations of Article 15, and that the information provided be compiled into a table to be appended to the Committee's annual reports. Since 2003, subsequent annual reports of the Committee have contained information on the implementation of Article 15.[24]

### (5) Committee on Subsidies and Countervailing Measures

Pursuant to procedures adopted at the Doha Ministerial Conference[25], the Committee on Subsidies and Countervailing Measures has adopted annual decisions providing for an extension of the transition period for the elimination of export subsidies by certain developing country Members. The General Council recently adopted a decision[26] to continue this procedure for the adoption of annual extension decisions during the period 2008 to 2012. The adoption of such annual decisions by the Committee is subject to review by the Committee to ensure compliance with certain transparency and standstill requirements. This review takes place based on updating notifications submitted by the Member in question.

### (6) Committee on Safeguards

The Committee on Safeguards does not have a specific function of monitoring S&D. However, it does carry out the review of notifications from various Members which includes, if relevant, notifications concerning the application of the S&D provision contained in Article 9.1 of the Safeguards Agreement.

22. WT/MIN(01)/17, paragraph 7.4
23. G/ADP/9.
24. Annex E of documents G/L/653 (2003), G/L/707 (2004), G/L/758 (2005), G/L/791(2006) and G/L/830(2007).
25. See document G/SCM/39.
26. See document WT/L/691.

## C. Subsidiary Bodies of the Council for Trade in Services

### (1) Working Party on Domestic Regulation

Pursuant to GATS Article VI:4, Members in the Working Party on Domestic Regulation have been considering possible disciplines on domestic regulation. Among the possible disciplines that have been identified, Members have proposed disciplines on development.[27] These disciplines include the right for a Member to accord reduced administrative fees to service suppliers from developing country Members, as well as longer phasein periods of new licensing requirements and procedures, qualification requirements and procedures, and technical standards in service sectors and modes of supply of export interest to developing country Members. In addition, developed country Members, and to the extent possible other Members, have been called up to provide technical assistance to developing country Members and in particular LDCs, upon their request and on mutually agreed terms and conditions aimed at, among other things, developing and strengthening institutional and regulatory capacities to regulate the supply of services and implement these disciplines and assisting them to meet the relevant requirements and procedures in export markets.

Furthermore, Members are proposing that the Council for Trade in Services establish a Committee on Domestic Regulation to oversee the implementation of the disciplines, as well as the operation of Article VI of the GATS including any further work under Article VI:4 of the GATS. In addition, it has been proposed that the Council for Trade in Services, upon the request from any Member, review the operation of the future disciplines and make recommendations as appropriate.[28]

### (2) Committee on Government Procurement (1994 Agreement)

Article V:14 of the Agreement on Government Procurement calls for an annual review of the operation and effectiveness of Article V of the Agreement which relates to "Special and Differential Treatment for Developing Countries". In addition, it calls for a "major review" in every three years of the operation of Article V on the basis of reports to be submitted by Parties, in order to evaluate its effects. As part of the three-yearly reviews and with a view of achieving the maximum implementation of the provisions of the Agreement, and having regard to the development, financial and trade situation of the developing countries concerned, the Committee is mandated to examine whether exclusions provided for in accordance with the

27. Paragraphs 43-45 of the Chairman's informal note on 'Disciplines on Domestic Regulation Pursuant to Gats Article VI:4'.
28. Paragraphs 47-48 of the Chairman's informal note on 'Disciplines on Domestic Regulation Pursuant to Gats Article VI:4'.

provisions of paragraphs 4 through 6 of Article V shall be modified or extended. In recent years, the whole of the Agreement on Government Procurement as a whole, including Article V, has been under active review and re-negotiation by the Parties. A revised text has been developed which is intended to replace the text of the existing Agreement. The revised text will incorporate a new provision in favour of developing countries which is considered to set out more clearly and specifically the flexibilities that are available to developing countries under the Agreement.[29] The operation and effectiveness of the new provision is to be reviewed every five years.

## 1.4. Determination of "Developing Country" in the GATT/WTO

There have been controversies on whether or not a country should receive the special and differential treatment reserved in the WTO Agreements for developing economies. Similar discussions have not taken place in the case of least-developed countries because these are clearly identified in the United Nations list of LDCs which is accepted by the WTO. In addition, the former Soviet Union countries in Central and Eastern Europe are referred to as transition economies and are excluded from the list of developing countries.[30]

In the GATT/WTO system, there is no formal definition of a developing country. However, there has been an informal group of such countries, the chairman of which invites new Members to join if they claim that status. The system worked satisfactorily under GATT, and 98 out of 128 GATT members were accepted as developing countries.

This practice has been basically intact in the WTO system. The determination of a developing country status is still based on self-declaration. This practice has raised little problem, particularly at the current stage of the WTO, in which most of the transition periods rendered to developing country Members already expired. Because there is no visible benefit for a developing country, somewhat loose practices in determining the developing country status does not cause serious conflicts in implementing the WTO Agreements.

But, as sectoral negotiations under the Doha Development Agenda (DDA) have been substantially progressed, the status of a developing country has again raised some controversy in terms of agricultural negotiations in which special and differential treatment for a developing country has significant implication for Members. For example, Members such as Korea, Taiwan (or Chinese Taipei), and China are currently arguing for the developing country status,

29. Article IV of GPA/W/297.
30. Romania is the rare exception to be recognized as a developing country while it is considered as a transition economy. Raj Bhala and Kevin Kennedy, World Trade Law, 400-401 (1998).

whereas other Members oppose to such arguments.[31]

### Doha Negotiation

In the Doha negotiation, the criteria to determine developing countries have not been elaborated. Yet the WTO Members agree on some of special and differential treatment packages, especially in non-agricultural market access (NAMA) area. The modality for tariff reduction provisionally agreed among major Members is as follows[32]:

The following formula shall apply on a line-by-line basis:

$$t_1 = \frac{\{a \text{ or } (x \text{ or } y \text{ or } z)\} \times t_0}{\{a \text{ or } (x \text{ or } y \text{ or } z)\} + t_0}$$

where,
$t_1$ = Final bound rate of duty
$t_0$ = Base rate of duty
a = 8 = Coefficient for developed Members
x = 20, y = 22, z = 25 to be determined = Coefficients for developing Members.

The flexibilities provided for the above formula shall not be used to exclude entire HS Chapters. In order to ensure tariff reduction in every Chapter, without substantially limiting the flexibilities provided to developing Members, this provision shall be understood to mean that full formula tariff reductions shall apply to a minimum of either 20 percent of national tariff lines or 9 percent of the value of imports of the Member in each HS Chapter.

However, this convergence is conditional on agreement on a number of elements in the negotiations on agriculture, and was accepted by many Members only “as a package”. Agreement was not reached on all of the agriculture modalities in that “package”. In addition, some Members’ support was conditional upon the outcome of negotiations on other issues - issues which were not part of the “package” and remained to be addressed. These other issues were not agreed and, therefore, the convergence on the NAMA issues within the “package” remains just substantial convergence, but not “consensus”.

31. Despite its failure to be treated as a developing country during the accession negotiation, China appears to be in a much better situation in the Doha agricultural negotiation in which a “recently acceded Member” category is newly created.
32. WTO, JOB(08)/96 (Aug. 12, 2008).

## 1.5. "Developing Country" in the Accession Negotiation

Among the subjects which have risen most in the discussion in Working Parties for WTO Accession are whether or not the applicant country in question should receive the special and differential treatment reserved in the WTO Agreements for developing economies. As it has been difficult to resolve this issue, participants in a number of Working Parties have taken the view that it is more productive not to discuss the principle involved but to concentrate on the terms that are appropriate in each accession case and in relation to each subject dealt with by the Working Party.[33]

Several applicant countries have requested that they be granted transitional periods provided in WTO Agreements for developing Members and, in some instances, for Members in the process of transformation from a centrally-planned into a market, free-enterprise economy. It is the position of some WTO Members that only original Members of the WTO are entitled to use the transitional periods referred to, which form part of the single undertaking of the WTO Agreement. Some Members state that a transitional period should not ordinarily be granted. In this connection, some Members make it plain that where existing legislation is deficient or lacking, draft laws and regulations in full conformity with WTO rules be presented to the Working Party for examination, together with a timetable for their implementation.

Others say that they are not, a priori, opposed to transitional periods for applicants but that applicants must demonstrate that they have done as much as they can to bring their system into conformity with WTO requirements before asking for transitional periods. Some others urge flexibility in this matter, especially for small developing economies and least-developed countries.

Consequently, acceding governments usually present a plan and timetable showing, for each of the main subjects dealt with in the Working Party, what steps they have taken towards conformity, what remains to be done and how and when they expect to complete this process. This then becomes the subject of negotiations in the Working Party on the terms to be included in the Protocol.

So far, this issue has been controversial in terms of Article 6.4 of the Agreement of Agriculture that provides:

33. WT/ACC/7/Rev.2 (Nov. 1, 2000), p.21.

*Article 6 Domestic Support Commitments*

4. (a) A Member shall not be required to include in the calculation of its Current Total AMS and shall not be required to reduce:

(i) product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of that Member's total value of production of a basic agricultural product during the relevant year; and

(ii) non-product-specific domestic support which would otherwise be required to be included in a Member's calculation of its Current AMS where such support does not exceed 5 per cent of the value of that Member's total agricultural production.

(b) For developing country Members, the de minimis percentage under this paragraph shall be 10 per cent.

The arrangements for newly acceded Members all vary for the above provision.

## A. China Case

In its WTO accession negotiation, China insisted that it should be able to join the WTO with developing country status while several WTO Members strongly opposed to it. China's view is understandable, because not only does it reflect accurately the economy's current stage of development but also it would bestow in many respects more WTO rights and fewer obligations on China. One of the perceived benefits would be longer transition periods both for meeting WTO accession demands and for complying with on-going liberalization commitments under the Uruguay Round. Another benefit of developing country status is that China would have access to the many other special and differential treatments in the WTO Agreements. Two of those that particularly worry some of China's trading partners are provided in GATT Articles XII and XVIII, which allow a developing country to restrict imports when it faces difficulties in its balance of payments or seeks to retain protection for a particular 'infant' industry (automobiles being the key candidate in China's case). While not often used by WTO Members in the past, Article XII would give China the legal right to renege on its market access commitments following its accession as a developing country, should it be able to convince the IMF that it had a serious problem with its balance of payments that cannot be addressed better by other means such as a devaluation. The concern of some WTO Members that China might try to (ab-)use its legal right made them very reluctant to accept developing country status of China even though its per capita income level would suggest that status is appropriate.[34]

Although China has not been granted across-the-board preferential treatment as a developing country, it has negotiated specific transitional arrangements in certain areas of its trade regime. Examples include the phasing out of quotas and import licenses, and the phased liberalization of the right for foreign entities to trade in China. In contrast, despite the availability of more preferential treatment under the WTO agreements, China has accepted a special cap on its ability to provide domestic production subsidies in agriculture, has agreed not to use export subsidies, and has committed to immediate implementation of the TRIPS Agreement.[35]

In terms of de *minimis* support stipulated in Article 6.4 of the Agreement on Agriculture, China set 8.5 per cent as the criteria, which is between 5% for developed members and 10% for developing Members, as indicated in the following paragraph of the Working Party Report.

> 235. In implementing Article 6.2 and 6.4 of the Agreement on Agriculture, the representative of China confirmed that while China could provide support through government measures of the types described in Article 6.2, the amount of such support would be included in China's calculation of its Aggregate Measurement of Support ("AMS"). He noted that China's Total AMS Commitment Level was set forth in Part IV, Section I of China's Schedule. The representative of China further confirmed that China would have recourse to a *de minimis* exemption for product-specific support equivalent to 8.5 per cent of the total value of production of a basic agricultural product during the relevant year. The representative of China confirmed that China would have recourse to a *de minimis* exemption for non-product-specific support of 8.5 per cent of the value of China's total agricultural production during the relevant year. Accordingly, these percentages would constitute China's *de minimis* exemption under Article 6.4 of the Agreement on Agriculture. The Working Party took note of these commitments.[36]

The level of 8.5 per cent as the *de minimis* criteria is indeed a very unique arrangement. The decision on this level is basically the outcome of the accession negotiation that compromises the demand by China for developing country benefits and the reluctance by other Working Party Members.

## B. Vietnam Case

In the Vietnamese case, it appears that there was no serious controversy or objection regarding the *de minimis* treatment. So, 10 per cent threshold was accepted as indicated in the

34. Kym Anderson, "On the Complexities of China's WTO Accession", World Economy, 764-765 (1997).
35. Jeffrey L. Gertler, "What China's WTO Accession Is All About?", in China and the WTO: Accession, Policy Reform, and Poverty Reduction Strategies, p. 26 (eds., D. Bhattasali, et al., 2004).
36. WTO, WT/ACC/CHN/49.

Working Party Report below.

> 368. He provided information on domestic support and export subsidies in agriculture for the period 1999-2001 in document WT/ACC/SPEC/VNM/3 of 5 November 2002, last revised in August 2006 (WT/ACC/SPEC/VNM/3/Rev.7). In calculating the Total Aggregate Measurement of Support, Viet Nam applied a *de minimis* level of 10 per cent. He noted that most of Viet Nam's support measures were considered "Green Box" policies. Viet Nam's commitments on domestic support in agriculture are contained in Viet Nam's Schedule of Concessions and Commitments on Goods annexed to Viet Nam's draft Protocol of Accession to the WTO.[37]

## C. Latvia

On the other hand, Latvia took the lump-sump threshold of SDR 24 million that is approximately 8 per cent of the average value of final agricultural production during the period 1994-1996. More concrete arrangement is provided as follows.

> 109. The representative of Latvia said that during a transition period to expire on 1 January 2003, Latvia would forego the 5 per cent *de minimis* exemption for product-specific domestic support and for non-product specific domestic support in calculating its Current Total AMS as provided for in paragraph 4 (a) of Article 6 of the Agreement on Agriculture, provided that the sum of product-specific and non-product-specific domestic support does not exceed SDR 24 million (representing approximately 8 per cent of the average value of final agricultural production during the period 1994-1996) and that SDR 24 million instead constitutes Latvia's *de minimis* exemption under Article 6.4 (a) during each year of the said transition period. Accordingly, during the transition period, Latvia would not be required to include product-specific domestic support or non-product specific domestic support in calculating its Current Total AMS pursuant to paragraph 4 (a) of Article 6 of the Agreement on Agriculture, and would not be required to reduce such domestic support in accordance with paragraph 1 of Article 6 of the Agreement on Agriculture, where the sum of product-specific and non-product specific support does not exceed SDR 24 million during the relevant year. The Working Party took note of these commitments.[38]

## D. Chinese Taipei

Chinese Taipei accepted 5 per cent *de minimis* exclusion criteria during its accession negotiation. Although that arrangement was not explicitly included in the Working Party

37. WTO, WT/ACC/VNM/48
38. WTO, WT/ACC/LVA/32.

Report, the document including information tables concerning domestic support and export subsidies contains the following statement to indicate that Chinese Taipei agreed on 5 per cent *de minimis* exclusion criteria.

AMS is not subject to reduction or inclusion in the current AMS because the calculated AMS is less than 5 per cent of value of production (*de minimis* exclusion).[39]

### E. Ukraine

Ukraine also used 5 per cent *de minimis* exclusion criteria. In calculating "Current Total AMS", Ukraine adopted the following formula[40]:

Current Total AMS = Product-specific AMS
+ Product-specific measurements of support
+ Non-product-specific AMS
if the sum > *de mimimis 5%* of production value.

Current Total AMS = 0
if the sum < *de mimimis 5%* of production value.

In other words, Ukraine accepted the *de minimis* exclusion threshold for developed countries for the purpose of Article 6.4 of the Agreement of Agriculture.

## 2. "Developing Country" Status for Korea

### 2.1. Korea in the GATT System[41]

Korea joined the GATT in 1967 in the final phase of the Kennedy Round as the 71st Contracting Party. The decision to join the GATT was carefully weighed by the Korean Government for several years since it launched the First Five Year Economic Development Plan (1962-1966).However, once the decision had been made to accede to the GATT, the process

39. WT/ACC/SPEC/TPKM/4/Rev.3, p.9.
40. WT/ACC/SPEC/UKR/1/Rev.12, p.5.
41. This part is based on Dukgeun Ahn (2003), "Korea in the GATT/WTO Dispute Settlement System: Legal Battle for Economic Development", Journal of International Economic Law, V.6, No.3, 597-633 and Chulsu Kim, "Korea" in The World Trade Organization: Legal, Economic and Political Analysis (eds., by Macrory, P. et al., 2005), 183-214.

was extraordinarily swift. The application was made on May 20, 1966, and after five months of negotiations from September 1966 to February 1967, process of accession was completed in April 1967.

Interestingly enough, Korea's introduction to the GATT had come much earlier. Korea, as a newly independent nation after World War Ⅱ, sent a delegation to Torquay, England in September 1950 to participate in the second trade round under the aegis of the GATT and to seek accession to the GATT. The records show that, in Torquay, Korea made tariff concessions on 31 items, including bituminous coal, chemical fertilizers, cotton, pesticides, whiskey and champaigne. The Korean delegation also signed the Protocol of Accession[42] which was endorsed by 25 of the 34 Contracting Parties of the GATT at the time. The accession did not materialize as the country failed to take necessary steps, including the ratification of the Protocol of Accession, in the midst of the Korean War.[43] As a poor country with hardly any international trade at the time, the decision to seek membership in the GATT in 1950 was primarily motivated by the desire of the Korean Government to receive political recognition in the international community, particularly by seeking membership in any and all international organizations, after its independence from Japan after World War Ⅱ.

Unlike at the time of the Torquay Round, Korea's decision to pursue the GATT membership in 1966 was much more deliberate and commercially motivated. The new government which came into power in 1962 through a military coup had launched an ambitious outward-oriented Five Year Economic Development Plan that year. Export promotion became one of the central policy thrusts of the Plan. Thanks to these policies, the Korean exports began to take off, albeit from a small base. The Korean exports grew annually by 45 percent, during the first five year plan, reaching US $250 in 1966.

In July 1963, the Director General of the GATT sent a letter to the Korean government recommending GATT entry. This put in motion studies in the trade-related ministries about the benefits and costs of such an entry. On November 15, 1965, President Chung-Hee Park instructed his government to officially review the desirability of GATT membership in one of the monthly Export Promotion Council Meetings at the Blue House, the Presidential Office. An inter-ministerial committee composed of ministries of trade, finance, and foreign affairs was created shortly thereafter for this purpose.

For a poor country pursuing an export-oriented development strategy, the GATT membership was important in terms of securing most-favored-nation (MFN) status from all 66

42. BISD, Vol. Ⅱ, May 1952, pp.33-34.
43. For a brief description of the Korean participation in the Torquay Round, see, Korean Customs Association, THE HISTORY OF TARIFFS IN KOREA(1958), pp. 354-355.

GATT Contracting Parties. Earlier, Korea concluded bilateral trade agreements with the United States (1956), Philippines (1961), Taiwan (1961) and Thailand (1961). As exports grew, more trade agreements were negotiated. However, this was a time-consuming and cumbersome procedure, and the GATT membership gave the means to avoid concluding endless bilateral agreements to gain the MFN status in overseas markets. The GATT membership was also perceived by the Korean policy makers as providing opportunities for cooperating with other developing countries in combating discrimination and protectionism against export items of interest to Korea, particularly in the agricultural and cotton textile sectors.[44]

It appears that the ministries concerned with trade policy, such as trade, finance, and foreign ministries, had also carefully examined the "cost" of GATT membership in the wake of the governments decision to apply. In particular, their main interest was whether Korea as a developing country could, under the existing GATT framework, maintain its flexibility with regards to the existing economic and trade policies which were marked by a high degree of government intervention in all sectors of economic policy. Such questions as to whether Korea could pursue its trade liberalization on its own pace or whether industrial subsidies have been provided appeared to have loomed large in the minds of policy makers examining the pros and cons of membership.[45] The addition of Chapter Ⅳ to the GATT in 1963, with its "more favorable and differential treatment" for developing countries was, therefore, an important development in this regard. It convinced the Korean policy makers that the GATT membership, while providing substantial benefit to Korea, did not overly constrain Korea's economic and trade policies because of its developing country status. The Korean government thus decided to pursue the GATT membership in early May 1966 and notified the GATT on May 20 Korea's intention to join the GATT and to participate in the Kennedy Round.

The tariff negotiation part of the accession process took place in Geneva from September to December 1966 and Korea's strategy was focused on limiting tariff concessions of its own, rather than gaining tariff concessions from her trading partners in the GATT. Korea's offer to seven Contracting Parties[46] which sought bilateral negotiations with Korea, was limited in scope and many offers were confined to the binding of the present tariff levels. They, therefore, were received with little enthusiasm. However, as Korea was still a minor developing country with a small trade volume and a low per capita income, the major trading partners of Korea seemed to have refrained from making many additional demands. When the negotiations were completed

44. How the Korean Government viewed the GATT accession is well explained by the Report to the Economic Ministers Meeting by the Minister of Foreign Affairs in the Proceeding of the Economic Ministers Meeting, No.138, May 9, 1966.
45. For background of Korea's decision to apply for membership, see, Hahm Tae-Hyuk, REFLECTIONS ON THE GATT ACCESSION NEGOTIATIONS (1993).
46. The U. S., Japan, EC, the United Kingdom, Canada, New Zealand, and Australia negotiated bilateral tariff concessions with Korea in the accession negotiation.

in December 1996, Korea made tariff concessions on 60 items, of which 41 items were bindings at the existing tariff levels, while 17 items were tariff reductions and two items were ceiling bindings. The combined imports of those 17 duty reduction items in 1965 was less than $1 million, or about 1.2 percent of Korea's total imports of $ 463 million registered for that year. The United States sought tariff reductions of several other items, including automobiles, but later relented. Japan withdrew their request for reductions under the condition that Korea would not seek any reciprocal concessions from Japan. New Zealand sought and received a 10 percentage tariff reduction on lamb meat tariff from 35 to 25 percent.

The GATT Working Party on Accession of Korea, composed of 14 Contracting Parties, met twice on November 30 and December 6, 1966 to examine the trade policy of Korea and to review Korea's plan to bring its trade regime into conformity with the GATT rules. The Korean delegation assured the Working Party members of its intention to further liberalize trade as Korea's balance of payments situation improves and as its infant industry gains its competitiveness. The Working Party adopted the Protocol of Accession[47] on December 8 and sent its report to the General Council, which approved Korea's accession to the GATT by consensus a week later. The post ballots were sent out by the GATT Secretariat on January 10, 1967 to fulfill the terms of Article XXXIII of the GATT, which required two-thirds majority for accession of new members. The two-thirds majority required was 47 votes out of 70 Contracting Parties and this was achieved as of March 1, 1967.

The ratification process in Korea was extraordinarily swift. On March 6, the GATT Secretariat notified the Korean Government that the requirements of accession under the Article XXXIII had been fulfilled. On March 8, the joint meeting of the Committees of Finance and Economy, Trade, Industry and Energy, and Foreign Affairs of the Korean National Assembly unanimously approved the country's accession without much discussion. Two days later, on March 10, the Plenary Session of the National Assembly also approved the accession unanimously, again without much discussion. The National Assembly's ratification paved the way for the Korean Ambassador in Geneva to sign the Protocol of Accession on March 15 and Korea became a new Contracting Party one month later, on April 14, 1967.

As a new Contracting Party in GATT, Korea was soon to benefit from 33 to 35 percent average global tariff cuts on some 41,111 items negotiated in the Kennedy Round, which was concluded in May 15, 1967. According to one Korean government estimate, Korea's benefits from tariff concessions of trading partners covered 44 percent of Korea's total exports in 1966.[48]

47. Korea's Protocol of Accession is contained in, BISD, 15th Supplement, April 1968, pp.44-46.
48. Korean Customs Association, THE TRADE OF KOREA AND GATT (1967), p.3.

When Korea joined GATT in 1967, the developing country status for Korea was not an issue due to a still aggrieved economic situation. In fact, Korea could invoke so-called "balance-of-payment exception" under GATT Article XVIII:B, which was exceptionally permitted for developing countries, to restrain importation into the domestic market. No country in the GATT had challenged the developing country status of Korea.

## 2.2. Korea during the Uruguay Round Negotiation

### A. Background

Korea was an active participant in the Uruguay Round. It played a significant role in both launching the round and in the negotiations as well. This enhanced role of Korea is owed to a number of developments that took place in Korea as well as in the international economy in the several years preceeding the launch of the round in 1986.

At home, Korea shifted from the heavy interventionist policies to a more market-based economic policies and embarked on an ambitious trade liberalization program since the beginning of the 1980s. Korea in the earlier decade experimented with import substitution policies under the Heavy and Chemical Industry (HCI) policy. Under this policy drive, officially announced in 1973, credit, interest rate tax and trade policies were used to promote development of "key" industries, such as iron and steel, non-ferrous metals, shipbuilding, machinery, automobiles, electronics and petrochemicals.[49] While this policy laid the foundation for industrial growth in Korea in the 1980s and beyond, it contributed to the serious structural imbalances and inflationary pressures in the Korean economy by the late 1970s. In 1979, the policy was officially abandoned, and the government began to take measures to correct resource misallocation emerging from the HCI policy and to enhance the competitiveness of Korean industries. Significantly, the Korean government took market opening measures as a first step. Starting in 1978, it began to take trade liberalization measures. By the end of 1979, import items subject to automatic licensing reached 70 percent of all tariff lines and the unweighted average tariff rate had been cut to just under 24%.

These trade liberalizing initiatives have been strengthened when the government subsequently launched a pre-announced three year program to expand the scope of automatic import licensing in 1983 and a five year program to reduce tariffs in 1984. These plans were renewed in subsequent years and continued until the early 1990s, when nearly all industrial products became subject to automatic import licensing and the average tariff rates were reduced

49. For HCI policy drive, see, Trade Policy Review of Korea, C/RM/S/27A, 2 June 1992, pp.9-10.

to 7.9% by 1994, with the brunt of protection remaining in agriculture. In 1985, industry-specific promotion laws enacted during the late 1960s and the early 1970s were replaced by the Industrial Development Act intended to promote restructuring and technological development on an industry-wide basis.

Under the new market-based macroeconomic policies and the ambitious trade liberalization programs, the Korean economy regained its competitiveness and performed well in 1985. Under these circumstances and with regained confidence, Korea began to look favorably upon the global effort to launch a new trade round. Another reason why Korea looked favorably toward the new multilateral trade negotiations was the perception in the trade policy circles that it might be an answer to a number of challenges facing Korea in the worsening global trade environment. The first of these challenges was the growing protectionism abroad. As Korea's presence in the world markets became more prominent, protectionist measures in the form of safeguard measures, gray-area measures, anti-dumping actions and countervailing duties were imposed with increasing frequency on Korean export products.

According to a study made by the Ministry of Trade and Industry, during 1982 to 1985, some 270 export items were subject to import restrictions in 21 industrial countries covering about 30% of total exports to these countries.[50] This took the form of QRS, voluntary export restraints, and the imposition of anti-dumping and countervailing duties. In 1984, Korea concluded a voluntary export restraint arrangement on steel products, another major export item, with the United States. As of end of 1985, many anti-dumping and countervailing duties have been imposed on Korean export products, ranging from photo albums and color television receivers. In 1985 alone, 15 new anti-dumping and countervailing duty investigations on Korean export products were initiated by Korea's trading partners, of which ten were undertaken by the United States.

The other challenge was the growing market opening pressures by Korea's trading partners. By the mid-1980s, Korea was beginning to face strong market opening pressures from its trading partners, particularly from the United States. Bilateral trade between the two countries expanded rapidly during the 1960s, 1970s and the 1980s. The United States was Korea's number one trading partner with the bilateral trade volume of $17 billion in 1985. Korean exporters' dependence on the United States market was considerable, with 35.5% of Korea's total exports going to that market in the same year. Korea's trade balance with the United States registered a surplus for the first time in 1982, and it expanded to $4.3 billion in 1985.

The United States began demanding market opening measures in 1983. Initially, it took the

50. CCCN 4-digit classification applied. See, Ministry of Trade and Industry, FORTY YEARS OF TRADE PROMOTION (1998), p.573.

form of demanding tariff reductions and removing quantitative restrictions in the goods sector. But later, a full trade offensive involving service sectors and the protection of intellectual property were undertaken, utilizing Section 301 of the U. S. Trade Act of 1974. In September and October of 1985, investigations and subsequent negotiations took place on Korea's insurance market and the protection of intellectual property rights. Under these negotiations, Korea promised to partly open fire and life insurance markets to U. S. firms and promised to modernize copyright, software and patent laws. In addition, several patent infringement cases involving Korean firms were filed with the USITC in the mid-1980s.

As Korea faced more protectionism abroad and pressures to open its domestic market by its trading partners, it became evident to its policy makers that Korea's overall economic interests were quite consistent with the objectives of the new trade round. It therefore became one of the most active supporters of the launching of a new trade.

Korea thus took a very positive stance toward the launching of a new round in Punta de Este, Uruguay in September 1986. The head of the Korean delegation, Woong-Bae Rha, Minister of Trade and Industry, strongly urging a consensus on launching the new round, advocated that both "old" and "new" issues should be discussed. He stated that Korea attached importance to "tighter safeguard principles, the elimination of non-tariff measures and the strengthening of dispute settlement procedures." As for the new issues, he believed that "the trading nations should recognize that the world economy is constantly evolving and that the trading system needs to be more responsive to this change, "but that the interests and concerns of developing countries should be fully reflected in adapting our trading system to meet new challenges."[51] He supported two other initiatives to strengthen the functioning of the GATT. One was to establish a permanent surveillance body in the GATT to monitor trade policies and practices of GATT Contracting Parties. The other was for ministers to become more involved in the decision-making process of the GATT by meeting periodically on a regular basis.

## B. Korea's Participation in the Uruguay Round

### (i) Objectives in the Round

Korea's objective in the Uruguay Round was much more clearly defined than in the previous round. The multilateral trading system was seen as providing the best means of resisting bilateral trade pressures and as an important constraint on protectionist pressures as well as on the negative aspects of the trend towards regionalism. Therefore, Korea was interested in

51. Korea : Statement by H. E. Woong-Bae Rha, Minister of Trade and Industry at the Meeting of the GATT Contracting Parties of Ministerial Levels, 15-19 September 1986, Punta de Este, Uruguay, MIN(86)/ST/ 11, 16 September 1986.

improving the GATT's ineffective dispute settlement procedure, to oppose selective safeguards, to stop abuses of anti-dumping measures, and to reintegrate textiles into the GATT. On the other hand, in agriculture, Korea's goal in the round was defensive. While supporting progressive liberalization in agriculture, Korea argued strongly that certain agricultural products including rice should be shielded from foreign competition.

As far as the new areas are concerned, Korea did neither have a strong service sector nor a strong system of protection of intellectual property rights. Therefore, Korea was not in the forefront of those countries which argued strongly for the liberalization and protection in these areas. However, Korea supported the inclusion of these sectors in the new round in the name of strengthening and bringing up to date the rules of the multilateral trading system. As for the intellectual property rights, Korea had already embarked on modernization of its laws, partly in response to the bilateral trade pressures of industrialized countries, in the early 1980s, particularly by the United States. As a result, the new negotiations were not expected to bring overly difficult new obligations to Korea. It was also thought widely that strengthening of intellectual property rights would be crucial to technological advancement in Korea.

The service sector in Korea has come to occupy more than 50 percent of Korea's GDP at the turn of the 1980s and 55.9 percent by 1985. According to the GATT statistics, Korea's service exports reached $8 billion and imports $5 billion respectively in 1987, making Korea the 15th largest exporter and 19th largest importer of services in the world by 1987. Despite the size of the service industry in Korea, however, the industry as a whole lagged behind the manufacturing sector due to the small market, heavy regulations and low level of productivity and research and development in many sectors of services. Therefore, the inclusion of services in the negotiation was generally seen as a burden to the Korean economy. On the other hand, Korea was seen to have comparative advantage in construction services and in the movement of natural persons.

### (ii) Korea in the Negotiations

Korea played a much more important role in the Uruguay Round compared with that in the Tokyo Round. The more important role for Korea was a reflection of the enhanced status of Korea as a trading nation. By 1986, Korea became the 12th largest trading nation in the world with a two-way trade volume of $66 billion. Its industries, such as textiles, electronics, shipbuilding, steel and automobiles were already global in scale and in competitiveness. Korea thus had an important stake in the outcome of negotiations, and the Korean government placed a high priority in the negotiations by increasing resources for the negotiations as well as putting into place a national framework of preparations for negotiations.

In December 1986, the government created an inter-agency committee on the Uruguay

**Table 2-1 | Written Proposals by Korea in the Uruguay Round**

| Document No. | Date | Subject |
|---|---|---|
| 1. MTN. GNG/NG7/W6 | 1 June 1987 | Article 28 |
| 2. MTN. GNG/NG7/W/59 | 3 November 1989 | Article 28* |
| 3. MTN. GNG/NG8/W3 | 20 May 1987 | Anti-Dumping |
| 4. MTN. GNG/NG8/W/10 | 30 September 1987 | Anti-Dumping |
| 5. MTN. GNG/NG8/W/40/Add.1. | 22 November 1988 | Anti-Dumping |
| 6. MTN. GNG/NG8/20/40 | 22 November 1988 | Anti-Dumping |
| 7. MTN. GNG/NG8/40/Add.2 | 20 December 1989 | Anti-Dumping |
| 8. MTN. GNG/NG9/W/4 | 25 May 1987 | Safeguards** |
| 9. MTN. GNG/NG9/W/8 | 5 October 1987 | Safeguards** |
| 10. MTN. GNG/NG10/W/5 | 1June 1987 | Subsidies and Countervailing Measures |
| 11. MTN. GNG/NG10/W/11 | 22 October 1987 | Subsidies and Countervailing Measures |
| 12. MTN. GNG/NG10/W/21 | 17 June 1988 | Subsidies and Countervailing Measures |
| 13. MTN. GNG/NG1/W/13 | 16 November 1987 | Tariffs |
| 14. MTN. GNG/NG8/W/21 | 7 December 1987 | Government Procurement |
| 15. MTN. GNG/NG8/W/39 | 8 November 1988 | Government Procurement |
| 16. MTN. GNG/NG5/W/80 | 16 October 1988 | Agriculture |
| 17. MTN. GNG/NG5/W/178 | 24 July 1990 | Agriculture |
| 18. MTN. GNG/NG13/W/19 | 20 November 1987 | Dispute Settlement |
| 19. MTN. GNG/NG11/W/48 | 26 October 1989 | TRIPS |
| 20. MTN. GNG/TRIPS/W/1 | 12 July 1991 | TRIPS |
| 21. MTN. GNS/W/80 | 24 October 1989 | GATS |
| 22. MTN. GNG/NG2/RS/25 | 18 May 1990 | Non-tariff Measures |
| 23. MTN. GNS/CON/W/2 | 9 October 1990 | Construction Services |
| 24. MTN. SB/RBN/5 | 22 October 1990 | Rollback |
| 25. MTN. TNC/W/61 | 14 January 1991 | Trade in Services |

* Joint proposal with Argentina, Canada, Columbia, Czechoslovakia, Hong Kong, Hungary, Mexico, New Zealand and Singapore

** Joint proposal with Australia, Hong Kong, New Zealand, and Singapore

Round under the Economic Planning Board, which had a coordinating role in domestic and international economic policy matters. The Uruguay Round Committee, as it was called, was composed of high level officials from nearly all economic ministries and the foreign ministry. The Committee reported to the ministerial level International Cooperation Committee headed by the Deputy Prime Minister, who was concurrently the Minister of Economic Planning on important matters. The Uruguay Round Committee was also divided into seven subcommittees

composed of officials of relevant ministries and experts in the private sector. The positions developed by the subcommittees were screened and coordinated by the Uruguay Round Committee before being officially communicated to the various negotiating groups created under the Trade Negotiating Committee in Geneva.

Although Korea's experience in the multilateral trade negotiations was rather limited, it played a fairly active role in every phase of the Uruguay Round. This active role reflected the more diversified trading interest of Korea, which, by then, had emerged as the 13th largest trading nation. Unlike in the previous round, the Korean delegation made many written proposals independently of other countries in nearly every negotiating areas of the round. The Deputy Minister of Trade in the Ministry of Trade and Industry was chosen as the Chairperson of NG8, the Negotiating Group on MTN Agreements. As Table 2-1 shows, Korea made some 25 written proposals during the Uruguay Round. They covered issues such as dispute settlement, safeguards, anti-dumping, subsidies, agriculture, services, and intellectual property. The most extensive Korean proposal was probably in the area of anti-dumping, where Korea initially proposed renegotiations in at least 13 issues of the anti-dumping code agreed during the Tokyo Round.[52]

At the initial stage of the Uruguay Round negotiation, there was no serious dispute concerning Korea's developing country status. The United States was the main country to oppose to the position of Korea that demanded the status as developing country. The European Communities joined later but was not very keen about this issue. Other countries, including Japan, were generally favorable to the argument of Korea.

During the Uruguay Round negotiation, only 13 Members, including United States, Canada, EU, Japan, Switzerland, Norway, Finland, Australia, New Zealand, Poland, Czech Republic, Slovak, South Africa, submitted their commitments to reduce domestic support as developed countries.  Other WTO Members, including Korea, submitted their commitments as developing countries.

### (iii) Uruguay Round Results and Korea

The Korean reaction to the results of the Uruguay Round was generally favorable except in agriculture. The market access results were seen in Korea as creating new export opportunities for Korea. The 35 percent tariff reductions by industrial countries and the substantial lowering of tariffs and tariff bindings on the part of developing countries were significant market access improvements for Korea. On Korea's part, its market access commitments were considerable.

52. MTN. GNG/NG8/W/3, 20 May 1987.

On industrial products, tariff bindings increased from 24 percent to 89 percent of all tariff lines. Tariffs were to be reduced from the base level of 24 percent to 8.3 percent by 2004, which was a reduction of 54 percent. Korea also participated in zero for zero negotiations initiated by the Quad countries. Out of 75 items, Korea agreed to zero tariff on 50 items, agreed to an eight to ten year transition period for 17 items, and did not concede in 8 items such as x-ray equipment, other medical equipment, and penicillin. Korea also participated in tariff harmonization on chemical products, making concessions in 193 of 196 total items. These substantial tariff commitments, however, did not require a major overhaul in Korea's tariff structure, as many concessions were well within the existing tariff rates resulting from the unilateral reductions since the 1980s.[53]

The strengthening of the rules and the dispute settlement mechanism in the round was widely received in Korea as a welcome development as they were expected to reduce unilateral trade pressures on the part of major trading partners. The phase-out of grey-area measures, strengthened rules in anti-dumping and countervailing duties, negotiated in the Uruguay Round, were also expected to act as a strong deterrent to protectionism facing Korean exports. The ten year phase out of the MFA under the Agreement on Textiles and Clothing was generally seen as a disadvantage rather than an advantage by the Korean textile industry as its global market share accumulated with a large quota was expected to be reduced in the liberalization process to low-cost suppliers. In a few cases, the new Uruguay Round agreements created new obligations in Korea's trade policy. The Agreement on Subsidies and Countervailing Duties, which introduced new disciplines in the subsidies, imposed new requirements to phase out Korean subsidies related to exports and domestic production. Under the Agreement on Import Licensing which became a multilateral agreement as a result of the Uruguay Round, Korea was required to phase-out Import Diversification Program targeted against Japan. Under this program, which was introduced in 1978, the products of Japanese origin were not allowed to be imported into Korea for domestic consumption even when the same product was liberalized, and therefore could be imported from elsewhere.

In the new areas, Korea's commitment was expected to be substantial. In reality, however, they turned out to be only moderate. In services, Korea has assumed commitments in about half of the negotiated service sectors, i.e., 78 out of 155 total service sectors. Korea made the full commitments in construction and engineering services, but its commitments in other services such as financial, telecommunications, transportation services were only partial. Korea did not make any commitments in educational, health and social services as well as in recreational,

53. For a general discussion of Korea's commitment in the Uruguay Round, see, Choi, N., Trade Opportunities in the Post-UR Regime: Korea's Perspective, KIET OCCASIONAL PAPERS, No. 19. See also, Ministry of Foreign Affairs, THE RESULTS AND ASSESSMENT OF URUGUAY ROUND RESULTS (1994), pp.31-39.

cultural and sporting services, among others. Korea's commitment also included only one MFN exemption in, computer reservation services, thereby offering non-discriminatory treatment in virtually all service sectors where concessions had been made. In intellectual property rights, the TRIPS Agreement introduced a high standard for protection. However, Korea had already introduced strong protection in all areas of intellectual property laws, partly due to the bilateral agreements negotiated with major trading partners during the mid-1980s. Korea's new obligations in this area were few, such as extension of patent and computer software protection periods and the introduction of color trademarks.

In agriculture, Korea's participation was defensive and very controversial at home. Korea's negotiations with its trading partners had also been complicated due to the recommendation of the BOP Committee in 1989, when Korea agreed to phase out all quantitative restrictions by July 1, 1997. Korea resisted tariffication without exception until the very last phase of the negotiation. In the end, Korea received a special treatment on rice as Japan, but more favorable treatment as a developing country. Tariffication on rice could be delayed until 2004, while guaranteeing minimum market access (MMA). In 1995, the MMA was to be 1 percent of the domestic consumption, rising annually by 0.25 percent each year until 1999, after which it was to rise annually by 0.5 percent each year through 2004, when the MMA quota was to reach 4 percent of domestic consumption. On beef, the existing quota system was to be extended until 2000 with the tariffs to be increased from 20% to 40%. In the meantime, the beef quota was to be increased from 123,000 tons in 1995 to 225,000 tons in 2000. For chicken and pork, quantitative restrictions were to be lifted by July 1, 1997, as was agreed in the BOP consultation in 1989, but their tariffs were to be raised from 20 percent to 35 percent for chicken and 25 percent to 37 percent for pork. During 1995 to 1997, 3.5 percent of domestic consumption in these products were to be allowed under the import quotas. Similar arrangements applied for mandarin oranges and orange juice, for which 3% of the domestic consumption was to be allowed in as import quotas from 1995 to 1997 when quantitative restrictions were to be removed.

While Korea had made a very difficult decision in the Uruguay Round with respect to agricultural liberalization which would require a wide-ranging structural adjustment in the sector, the overall assessment of the round by the Korean government was quite positive. The Korean Trade Minister attending the Marrakesh Meeting stated that the "Uruguay Agreement has substantially strengthened the principle of multilateralism," and that "it has, inter alia, reduced barriers in various sectors, made the rules more transparent and introduced a stronger dispute settlement system." He went on to say that " I am confident that this agreement will go a long way toward helping maintain Korea's development momentum."[54]

54. Statement by Mr. Chulsu Kim, Minister of Trade, Industry, and Energy, 12 April 1994, Marrakesh, MTN.TNC/MIN(94)/ST/19.

### (iv) Implementation

Immediately after the conclusion of the Uruguay Round in December 1993, the Korean government began to revise relevant laws in accordance with the new WTO agreements. As a result, Korea had almost completed its legislative work related to its Uruguay Round obligations as of December 1994, before the launching of the WTO. Even in areas where the implementation period had not expired, Korea has revised related laws in advance. As of end of December 1995, Korea had revised a total of 24 laws related to Uruguay Round agreements.[55] In the meetings of the WTO committees since, no serious slippages on the part of Korea to implement WTO Agreements had been pointed out by other Members, nor its implementation records been challenged in the dispute settlement mechanism of the WTO.

Despite no controversy on "developing country" status for Korea at its accession, Korea had achieved considerable industrialization and economic development during 1970-80s. This economic development caused controversy regarding "developing country" status, especially for the Uruguay Round negotiation which substantially strengthened the rules for world trade to make preferential treatment for developing countries much more significant and economically important.

## 2.3. Korea in the WTO System

In the Doha Development Agenda (DDA), the market liberalization commitment mandated for the WTO Members has been set or at least proposed at a very high level. Therefore, Korea has again desperately tried to secure special and differential treatment for developing countries, particularly in the context of agricultural negotiations.

### A. Sector Specific Approach

Instead of the overall status for a WTO Member, Korea tries to emphasize the importance of sector or product specific determination in terms of a developing country. For example, after losing the first GATT dispute in the Korea - Beef case, the Korean government notified the decision to dis-invoke the GATT Article XVIII:B exception in June 1989, which was accepted by the GATT Balance of Payment Committee on 27 October 1989. Pursuant to this decision, Korea graduated from the coverage of GATT Article XVIII:B from I January 1990. But, considering the fact that the remaining products were mostly sensitive, politically and socially, agricultural products, the eight year waiver period was granted to Korea.

55. Trade Policy Review of Korea, Report by Government, WT/TPR/G/19, p.7.

Moreover, when Korea joined the OECD in 1996, both the trade committee and the environment committee adopted the final report that accepted developing country status for agriculture and environment areas. The Korean government explained a variety of economic problems in the agricultural sector and also the arrangement as a developing country in that sector during the Uruguay Round.

### B. Arbitrary GSP System

Throughout the economic development periods from 1970s to 1980s, Korea was the beneficiary of the Generalized System of Preference (GSP). But, the United States excluded Korea from the GSP benefit, along with Hong Kong, Singapore, and Taiwan in January 1989. Korea was also excluded from the GSP list of the EU in 1996. Some WTO Members have argued that the elimination of Korea from the coverage of GSP system indicates the developed country status for Korea, at least in terms of WTO obligations. However, the status - or the graduation from the status - as the GSP beneficiary does not necessarily represent the general status of the country for the purpose of determining developing country status. In fact, Korea was recognized as developing country in the WTO even after the US government terminated the GSP benefit.

# 3. Policy Recommendations for Accession Negotiation

## 3.1. Strategies for “Developing Country” Status in Accession Negotiation

### A. Key Points to Argue in Accession Negotiation

Firstly, the general practice to treat similarly situated WTO members may be pointed out as the basis for claiming the non-discriminatory treatment to recognize “developing country” status. It is obvious that no country with similar economic situation to that of Azerbaijan in the GATT as well as the WTO system was considered “developed country”, i.e., demanded to make commitments at the level for developed countries. The requirement to liberalize the markets as well as to reduce government support at the current stage of economic development, especially considering the situation of market transition, should be seen as an overly excessive request for a newly acceding country. Therefore, the Azerbaijan government may argue the non-discriminatory treatment in the spirit of most-favored nation treatment for deciding “developing country” status.

Secondly, Azerbaijan may point out the fact that even Korea was recognized as a developing country at the Uruguay Round negotiation. In other words, technically speaking, when Korea acceded to the WTO, it was recognized as a developing country and granted with benefits for developing countries. This can be a very important precedent for Azerbaijan to claim the developing country status at least in terms of agricultural market liberalization and commitment.

Thirdly, the Azerbaijan government may explain to the working party group that the overly excessive request as part of the WTO accession negotiation may provoke too serious domestic political resistance. Unlike other market access negotiation issues whose economic significance is often opaque, the status of developing country is a clear issue even for the general public. Therefore, requesting too much in terms of WTO accession, in particular the request that has implications for domestic support, especially in the agricultural sector, still demanding considerable government assistance, would cause serious political resistance. The Azerbaijan government may emphasize such domestic political risks which can be too controversial to be accommodated. Hence, considering the actual economic benefit for a WTO member that insists "developed country" status for Azerbaijan, the Azerbaijan government may be able to persuade other WTO members to agree on a more rational trade and economic agenda instead of provoking symbolic - but unnecessarily too much controversial - political matters.

## B. Other Issues to Consider in Accession Negotiation

In the negotiation concerning developing country status, it should be noted that the issue is not a matter to be bargained over. In other words, whether Azerbaijan should be treated as developing country is the issue to be determined based on the principle, not on matters such as market access negotiation to be bargained. This means that the Azerbaijan government can take a stronger stance to defend its status as a developing country. In case the Azerbaijan government tries to bargain its status with other WTO members in the working party, it would inevitably require much more substantial concession than reasonably prepared, because many members would try to take advantage of the opportunities even if they might not have direct economic stake related to the issue.

Since every decision making, including accession negotiation, in the WTO system is based on consensus, the developing country status of Azerbaijan also does require the agreement of all working party members. Although this situation makes the decision on developing country status practically negotiable, the Azerbaijan government would be able to handle this issue better by separating from market access bargaining or negotiation.

Another point to be considered is that the developing country status itself does not guarantee "developing country" level market concession. In other words, even if the Azerbaijan government is able to secure developing country status, the market concession level agreed for

the accession condition may still be very substantial depending on the content of the negotiation. Therefore, it is very important to focus on the content of the market concession, rather than the developing country status itself.

In fact, the Korean government had the similar problems during the Uruguay Round negotiation. The Korean government was desperate to secure the developing country status to benefit from special and differential treatment stipulated under the Agreement on Agriculture, i.e., lower tariff reduction duty as well as lower domestic support reduction requirement. However, at that time, the United States raised strong objections on this argument. Consequently, the negotiation on developing country status was undertaken basically between Korea and the United States. This negotiation structure led the US government to make substantial requests to the Korean government, for example, regarding various agricultural products that are economically important to its domestic farmers, including, inter alia, beef, pork, chicken, orange and orange juice, and dairy products. Ultimately, the Korean government could achieve the two most symbolic success in agricultural negotiations: securing developing country status and elimination of rice from tariffication requirement. But, in return, the Korean government did make substantial market concessions for the above listed products in which the US government had considerable economic interest.[56]

In addition, Article XIII of the WTO Agreement provides that the WTO Agreements shall not apply between any Member and any other Member, if either of the Members, at the time either becomes a Member, does not consent to such applications and if they notify the General Council before its approval of the agreement on the terms of accession. As of July 2008, Article XIII has been invoked eight times and they are still maintained.

**Table 2-2 | Article XIII Invocation for WTO Accession**

| Acceding Member | Member Invoking Article XIII | Status |
|---|---|---|
| Mongolia | United States | Withdrawn on 1999.7.7 (WT/L/306) |
| Kyrgyz Republic | United States | Withdrawn on 2000.9.18 (WT/L/363) |
| Georgia | United States | Withdrawn on 2001.1.8 (WT/L/385) |
| Armenia | United States | Withdrawn on 2005.2.2 (WT/L/601) |
| Armenia | Turkey | Invoked on 2002.11.29 (WT/L/501) |
| Viet Nam | United States | Withdrawn on 2007.1.7 (WT/L/306) |
| Moldova | United States | Invoked on 2001.5.2 (WT/L/395) |
| China | El Salvador | Invoked on 2001.11.5 (WT/L/429) |

56. White Paper on Uruguay Round Agriculture Negotiation, J. Lee et al., p.121 (KREI, 1994, 11).

As shown in Table 2-2, the United States typically invoked Article XIII of the WTO Agreement against former CIS countries, including Georgia, Armenia, and Kyrgyz Republic. Although the accession by Ukraine was not opted out under Article XIII by any Member, Azerbaijan needs to pay attention to this practice especially by the United States.

## 3.2. Implication for the Status of Azerbaijan in the WTO System

The "developing country" status at the accession stage may have some important implications for future trade policy under the WTO system. But, as of 2008, the developing country status has much less meaning even for developing country members.

As explained in Section 1, various parts of the WTO Agreements contain special and differential treatment for developing countries. But, in terms of binding legal obligations, the WTO Agreements typically stipulate longer transition periods for developing countries, instead of weaker or discriminatory obligations. For example, in the SCM Agreement, the developing countries are permitted to use export subsidies for 8 years and import subsidies for 5 years. But, all these benefits for developing countries already expired as of today for the incumbent WTO members. The requests by newly acceding countries to apply these transition provisions from the date they joined were invariably rejected in the WTO system. Therefore, as soon as Azerbaijan completes the accession procedure to the WTO, it will be very difficult to utilize "developing country" status in terms of legal obligations.

This situation raises two important policy implications. Firstly, it is very urgent to develop industrial development strategies and implement promptly so that the Azerbaijan government may legally adopt various government support programs without being challenged under the WTO rules. Although it appears very unlikely to have additional waiver periods for WTO obligations, at least the transition periods to introduce the WTO system permitted for a newly acceding member may be utilized to set up the foundational framework to initiate industry promotion strategies.

Secondly, the developing country status still has an important meaning for the agricultural market liberalization. Generally speaking, the legal duties for developing countries are about half the level for developed countries. In this regard, it is noted that the modality for agriculture negotiation in the Doha Development Agenda basically provides the same benefit for "recently acceded Member"(RAM) as for developing country Members. For example, both RAM and developing countries are supposed to reduce the overall trade-distorting domestic support by two-thirds of the rates applicable to developed countries. Moreover, the legal requirements for small low-income RAMs are even lower. Currently, "small low-income RAMs" include Albania, Armenia, Georgia, Kyrgyz Republic and Moldova. It is very likely that the WTO

Members include Azerbaijan in that list. It means that at least for the Doha Development Agenda, the developing country status is not the only channel to alleviate the legal burden for the agricultural sector in Azerbaijan. The new category invented as “small low-income RAMs” can replace the need to become developing country, and can even play a greater role to address the concern of domestic agricultural sector.

# Annex 1 PROCEDURES FOR WTO ACCESSION NEGOTIATIONS UNDER ARTICLE XII OF WTO AGREEMENT[57]

## General

1. In accordance with Article XII of the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement), a State or a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the matters provided for in the WTO Agreement and the Multilateral Trade Agreements (MTAs) annexed thereto may accede to the WTO on terms to be agreed between such State or separate customs territory and the Members of the WTO. Such accession shall apply to the WTO Agreement and the MTAs. Accession to a Plurilateral Trade Agreement annexed to the WTO Agreement shall be governed by the provisions of that Plurilateral Trade Agreement.

2. This note sets out procedures to be followed in the organization and pursuit of accession negotiations. It has been prepared by the Secretariat as a practical guide for delegations of both WTO Members and acceding States or separate customs territories and is not a general policy statement on accession negotiations. In accordance with Article XVI of the WTO Agreement, it follows decisions, procedures and customary practices of the GATT 1947 to the extent that these are relevant.

3. The procedures for accession to the WTO under Article XII require the examination of the foreign trade régime of the acceding State or separate customs territory; the negotiation and establishment of a schedule of concessions and commitments to GATT 1994 and a schedule of specific commitments to the General Agreement on Trade in Services (GATS) for such State or separate customs territory; agreement on the Report of the working party; and agreement on a Decision and a Protocol setting out the terms of Accession.

## Application and Establishment of Working Party

4. The acceding State or separate customs territory (the Applicant) submits a communication to the Director-General of the WTO indicating its desire to accede to the WTO under Article XII. The communication is circulated to all Members.

5. The General Council considers the application and the establishment of a working party. The terms of reference, in general, of working parties are “to examine the application for

57. WT/ACC/1.

accession to the WTO under Article XII and to submit to the General Council/Ministerial Conference recommendations which may include a draft Protocol of Accession". Membership in the working party is open to all interested Members. The Chairperson of the working party is appointed following consultations conducted by the Chairperson of the General Council involving the Applicant and members of the working party.

6. Upon the establishment of the working party, the Secretariat informs the Applicant of the procedures followed by working parties on accessions to the WTO, and the requirement that the Applicant submit a Memorandum on its Foreign Trade Régime that covers, but is not necessarily limited to, the topics listed in the attached outline format.

7. Technical assistance is provided by the Secretariat and may be provided by individual Members. The Secretariat may be invited to examine the specific assistance requirements of the Applicant so as to elaborate its own plans for assistance and to coordinate them, to the extent possible, with similar assistance being provided by individual Members. It is understood that the Secretariat would assist any Applicant that may so request in the technical preparation of its Memorandum and of subsequent documentation. The Applicant should also avail itself, to the extent possible, of the training activities of the WTO as part of its preparation for accession negotiations and to fully use its observer status, in particular, to follow meetings of other accession working parties and various WTO Councils and Committees.

8. Adequate lead-time should be allowed in the preparatory stage of accession negotiations before meetings of the working party are convened to enable both the Applicant and members of the working party to better prepare themselves. As a rule, there should be a sufficient lapse of time (generally four to six weeks) between the formal circulation of documentation and meetings of the working party. The dates of meetings are set after the agenda has been agreed in informal consultations and the relevant documentation circulated. The convening notice of meetings should specify the purpose of each meeting and the documentation before it.

### Memorandum on Foreign Trade Regime[58]

9. The Applicant submits a Memorandum describing in detail its foreign trade régime and providing relevant statistical data for circulation to all Members. The Secretariat should check the consistency of the Memorandum with the attached outline format and inform the Applicant and members of the working party of its views. At the same time, copies of the Applicant's currently applicable tariff schedule in the harmonized system (HS) nomenclature and other laws

58. WTO procedures relating to the use of the WTO official languages will apply to documentation submitted.

and regulations relevant to accession are made available to members of the working party. The customary practice in this respect has been that the Applicant send a complete and comprehensive copy of the relevant laws and regulations to the Secretariat. If the textual material is short, it should be entirely translated by the Applicant into one of the WTO official languages (English, French and Spanish); if it is long, the Applicant should provide a detailed summary in one of the official languages. The summary or the translated textual material is circulated to members of the working party with the original copy being retained for consultation in the Secretariat. The Secretariat should ensure that the above documentation is available in accordance with the guidelines set out in paragraph 8.

10. Following the circulation of the Memorandum, members of the working party are invited to submit questions in writing with a view to clarifying the operation of the Applicant's foreign trade régime. As a rule, answers should also be provided in writing and consolidated and arranged by topics in accordance with the structure of the Memorandum. Depending on the adequacy of the information provided, more than one round of questions and answers may be organized before the first meeting of the working party. Subsequent rounds should be designed to select and clarify issues before meetings of the working party, if necessary. Upon the request of any member of the working party, the Applicant submits information concerning the accession to the working party with regard to topics not listed in the attached outline format.

11. At the initial meeting of the working party, representatives from the Applicant and members of the working party examine the Memorandum and the questions and answers provided with a view to seeking any further clarifications that may be required in the light of the various provisions of the WTO Agreement and the MTAs. At the end of each meeting of the working party, the Chairperson generally outlines the state of play and the next steps required for the preparation of future meetings. This preparation should be carried out, inter alia, through informal consultations with members of the working party and the Secretariat, as necessary.

12. When the examination of the foreign trade régime is sufficiently advanced, members of the working party may initiate bilateral market access negotiations on goods and services and on the other terms to be agreed. It is understood that fact-finding work on the foreign trade régime and the negotiating phase can overlap and proceed in parallel.

## Schedules on Concessions

13. The procedures for negotiating schedules on concessions and commitments on goods and specific commitments on services may be summarized as follows:

(i) in the case of goods, either interested Members submit requests and the Applicant then tables initial offers, or, as a means of expediting the work, the Applicant tables its draft

Schedule of Concessions and Commitments to provide the basis for negotiations. In either case, negotiations then proceed bilaterally on the basis thus provided. Members expect that, in general, the Applicant will ensure that its proposed bindings are at commercially viable levels and reflect the general benefits the Applicant will enjoy upon membership;

(ii) in the case of services, either interested Members submit requests and the Applicant then tables its draft Schedule of Specific Commitments, or the tabling of a draft Schedule by the Applicant is followed by requests from interested Members. In either case, negotiations proceed bilaterally on the basis thus provided;

(iii) following the conclusion of bilateral negotiations between interested Members and the Applicant, the Schedule of Concessions and Commitments to GATT 1994 and the Schedule of Specific Commitments to the GATS are prepared, reviewed multilaterally and annexed to the draft Protocol of Accession as an integral part of it.

### Working Party Report, Protocol of Accession and Entry into Force

14. A summary of the discussions in the working party is reflected in the Report of the working party to the General Council/Ministerial Conference together with a draft Decision and Protocol of Accession. Frequently, some accession commitments are included in the Report of the working party and incorporated by reference in the text of the Protocol of Accession. The Protocol of Accession contains the terms of accession agreed by the Applicant and members of the working party and its provisions, therefore, reflect the particular case of the Applicant.

15. Once the negotiations on the schedules on goods and services are concluded and the working party has completed its mandate, the working party submits its Report, together with the draft Decision and Protocol of Accession, to the General Council/Ministerial Conference. Following the General Council/Ministerial Conference's adoption of the Report of the working party and the approval of the draft Decision by a two-thirds majority of the WTO Members' positive vote, the Protocol of Accession enters into force thirty days after acceptance by the Applicant, either by signature or by deposit of the Instrument of Ratification, if Parliamentary approval is required.

## Annex 2 SUMMARY TABLE OF ONGOING ACCESSIONS[59]

| Country | Application | Working Party Established | Memorandum | First/Latest * Working Party Meeting | Number of Working Party Meetings | Goods Offer | | Services Offer | | Draft Working Party Report** |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | initial | latest*+ | initial | latest* | |
| Afghanistan | Nov 2004 | Dec 2004 | | | | | | | | |
| Algeria | Jun 1987 | Jun 1987 | Jul 1996 | Apr 1998/ Oct 2005 | 9 | Feb 2002 | Jan 2005 | Mar 2002 | Jan 2005 | Jun 2006 |
| Andorra | Jul 1997 | Oct 1997 | Mar 1999 | Oct 1999 | 1 | Sep 1999 | | Sep 1999 | | |
| Azerbaijan | Jun 1997 | Jul 1997 | Apr 1999 | Jun 2002/ Mar 2006 | 4 | May 2005 | Apr 2007 | May 2005 | Mar 2007 | |
| Bahamas | May 2001 | Jul 2001 | | | | | | | | |
| Belarus | Sep 1993 | Oct 1993 | Jan 1996 | Jun 1997/ May 2005 | 7 | Mar 1998 | May 2006 | Feb 2000 | Sep 2006 | Apr 2005 (FS) |
| Bhutan | Sep 1999 | Oct 1999 | Feb 2003 | Nov 2004/ Oct 2006 | 3 | Aug 2005 | Apr 2007 | Aug 2005 | Apr 2007 | Sep 2006 |
| Bosnia and Herzegovina | May 1999 | Jul 1999 | Oct 2002 | Nov 2003/ Mar 2007 | 3 | Oct 2004 | Jun 2005 | Oct 2004 | June 2005 | Feb 2007 (FS) |
| Cape Verde | Nov 1999 | Jul 2000 | Jul 2003 | Jul 2005 Mar 2004/ | 3 | Nov 2004 | Nov 2005 | Nov 2004 | Nov 2006 | Nov 2005 |
| Ethiopia | Jan 2003 | Feb 2003 | Jan 2007 | | | | | | | |
| Iran | Jul 1996 | May 2005 | | | | | | | | |
| Iraq | Sep 2004 | Dec 2004 | Sep 2005 | | | | | | | |
| Kazakhstan | Jan 1996 | Feb 1996 | Sep 1996 Mar 1997/ | Nov 2006 | 9 | Jun 1997 | May 2004 | Sep 1997 | Jun 2004 | Sep 2006 |
| Lao People's Democratic Republic | Jul 1997 | Feb 1998 | Mar 2001 Oct 2004/ | Nov 2006 | 2 | Nov 2006 | | | | |

59. In alphabetical order. WT/ACC/11/Rev.7.

| Country | Application | Working Party Established | Memorandum | First/Latest * Working Party Meeting | Number of Working Party Meetings | Goods Offer | | Services Offer | | Draft Working Party Report** |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | initial | latest*+ | initial | latest* | |
| Lebanese Republic | Jan 1999 | Apr 1999 | Jun 2001 Oct 2002/ | May 2007 | 5 | Nov 2003 | Jun 2004 | Nov 2003 | Jun 2004 | Mar 2007 |
| Libyan Arab Jamahiriya | Jun 2004 | Jul 2004 | | | | | | | | |
| Montenegro | Dec 2004 | Feb 2005 | Mar 2005 Oct 2005/ | Feb 2007 | 3 | Jun 2006 | Feb 2007 | Jul 2005 | Jun 2006 | |
| Russian Federation | Jun 1993 | Jun 1993 | Mar 1994 Jul 1995/ | Mar 2006 | 30 | Feb 1998 | Feb 2001 | Oct 1999 | Jun 2002 | Oct 2004 |
| Samoa | Apr 1998 | Jul 1998 | Feb 2000 | Mar 2002 | 1 | Aug 2001 | | Aug 2001 | Feb 2006 | Nov 2006 |
| Sao Tomé and Principe | Jan 2005 | May 2005 | | | | | | | | |
| Serbia | Dec 2004 | Feb 2005 | Mar 2005 Oct 2005/ | Dec 2006 | 3 | Apr 2006 | | Oct 2006 | | |
| Seychelles | May 1995 | Jul 1995 | Aug 1996 | Feb 1997 | 1 | Jun 1997 | | May 1997 | | Jun 1997 |
| Sudan | Oct 1994 | Oct 1994 | Jan 1999 Mar 2004 | Jul 2003/ | 2 | Jul 2004 | Oct2006 | Jun 2004 | Oct 2006 | Sep 2004 (FS) |
| Tajikistan | May 2001 | Jul 2001 | Feb 2003 / Oct 2006 | Mar 2004 | 3 | Feb 2004 | Jun 2006 | Feb 2004 | Jun 2006 | May 2006 (FS) |
| Ukraine | Nov 1993 | Dec 1993 | Jul 1994 Feb 1995/ | Jun 2006 | 16 | May 1999 | May 2002 | Feb 1997 | Jun 2004 | Apr 2007 |
| Uzbekistan | Dec 1994 | Dec 1994 | Oct 1998 Jul 2002/ | Oct 2005 | 3 | Sep 2005 | | Sep 2005 | | |
| Vanuatu | Jul 1995 | Jul 1995 | Nov 1995 Jul 1996/ | Oct 1999 | 2 | Nov 1997 | Nov 1999 | Nov 1997 | Nov 1999 | Accession Package Oct 2001 |
| Yemen | Apr 2000 | Jul 2000 | Nov 2002 Nov 2004/ | Jul 2006 | 3 | Sep 2005 | Jun 2006 | Aug 2005 | Jun 2006 | Jun 2006 (FS) |

* As of the date of this document.
** Most recent Factual Summary (FS), draft Working Party Report or Elements of draft Working Party Report.

## Annex 3 THE WTO MEMBERSHIP STATISTICAL INFORMATION (2005)[60]

| | Category | Trade (US$, million) | | | | | GDP (current US$, million) | Population (thousand) | GDP/capita (US$/capita) |
|---|---|---|---|---|---|---|---|---|---|
| | | Merchandise Trade | | Trade in commercial services | | TOTAL | | | |
| | | Imports | Exports | Imports | Exports | | | | |
| Original WTO Members (128) | | | | | | | | | |
| | Total (absolute) | 9,302,102 | 8,663,637 | 2,063,042 | 2,218,870 | 22,247,651 | 39,771,400 | 4,246,640 | 9,504 |
| | Total(% world) | 86.7% | 82.8% | 89.5% | 91.5% | 85.8% | 89.4% | 66.7% | |
| Acceded WTO Members (under Art. XII) (23) | | | | | | | | | |
| 1 | Albania | 2,618 | 658 | 1,318 | 1,154 | 5,748 | 8,380 | 3,130 | 2,678 |
| 2 | Armenia | 1,768 | 950 | 377 | 323 | 3,418 | 4,903 | 3,016 | 1,625 |
| 3 | Bulgaria | 18,181 | 11,725 | 3,457 | 4,288 | 37,651 | 26,648 | 7,740 | 3,443 |
| 4 | Cambodia | 3,927 | 3,140 | 620 | 1,052 | 8,739 | 6,187 | 14,071 | 440 |
| 5 | China | 659,953 | 761,953 | 83,173 | 73,909 | 1,578,988 | 2,234,297 | 1,304,500 | 1,713 |
| 6 | Croatia | 18,560 | 8,773 | 3,349 | 9,920 | 40,602 | 38,506 | 4,443 | 8,666 |
| 7 | Ecuador | 10,309 | 10,100 | 2,049 | 940 | 23,398 | 36,489 | 13,228 | 2,758 |
| 8 | Estonia (EU)* | 10,212 | 7,693 | 2,132 | 3,117 | 23,153 | 13,101 | 1,346 | 9,733 |
| 9 | FYR Macedonia | 3,228 | 2,041 | 483 | 445 | 6,198 | 5,766 | 2,034 | 2,835 |
| 10 | Georgia | 2,491 | 867 | 578 | 631 | 4,567 | 6,395 | 4,474 | 1,429 |
| 11 | Jordan | 10,506 | 4,302 | 2,465 | 2,188 | 19,461 | 12,712 | 5,473 | 2,323 |
| 12 | Kyrgyz Republic | 1,108 | 672 | 287 | 234 | 2,301 | 2,441 | 5,144 | 475 |
| 13 | Latvia (EU)* | 8,697 | 5,161 | 1,541 | 2,137 | 17,536 | 15,826 | 2,301 | 6,879 |

60. WTO, Handbook on Accession to the WTO (2008).

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 14 | Lithuania (EU)* | 15,548 | 11,807 | 1,989 | 3,074 | 32,419 | 25,625 | 3,414 | 7,505 |
| 15 | Moldova | 2,293 | 1,091 | 418 | 409 | 4,211 | 2,917 | 4,206 | 694 |
| 16 | Mongolia | 1,184 | 1,065 | 495 | 382 | 3,127 | 1,880 | 2,554 | 736 |
| 17 | Nepal | 1,860 | 830 | 424 | 271 | 3,385 | 7,391 | 27,133 | 272 |
| 18 | Oman | 8,816 | 18,692 | 3,052 | 822 | 31,381 | 30,834 | 2,567 | 12,012 |
| 19 | Panama | 4,180 | 1,018 | 1,673 | 3,106 | 9,977 | 15,467 | 3,232 | 4,786 |
| 20 | Saudi Arabia | 59,409 | 180,737 | 14,239 | 5,916 | 260,302 | 309,779 | 23,119 | 13,399 |
| 21 | Chinese Taipei | 182,708 | 198,169 | 31,420 | 25,574 | 437,871 | 355,063 | 22,800 | 15,573 |
| 22 | Viet Nam | 36,978 | 32,442 | 5,282 | 4,176 | 78,878 | 52,408 | 83,119 | 631 |
| 23 | Tonga | 120 | 10 | 33 | 26 | 190 | 214 | 102 | 2,090 |
| | Total (absolute) | 1,064,655 | 1,263,896 | 160,853 | 144,096 | 2,633,500 | 3,213,228 | 1,543,146 | 2,082 |
| | Total (% world) | 9.9% | 12.1% | 7.0% | 5.9% | 10.2% | 7.2% | 24.2% | |
| Acceders (32) | | | | | | | | | |
| 1 | Afghanistan | 2,520 | 340 | ... | ... | 2,860 | 7,308 | ... | ... |
| 2 | Algeria | 20,357 | 46,001 | 2,997 | 1,825 | 71,181 | 102,256 | 32,854 | 3,112 |
| 3 | Andorra | ... | ... | ... | ... | ... | 66 | ... | ... |
| 4 | Azerbaijan | 4,211 | 4,347 | 2,625 | 625 | 11,808 | 12,561 | 8,388 | 1,498 |
| 5 | Bahamas | 2,230 | 562 | 1,296 | 2,455 | 6,542 | 5,502 | 323 | 17,031 |
| 6 | Belarus | 16,708 | 15,979 | 1,213 | 1,942 | 35,842 | 29,566 | 9,776 | 3,024 |
| 7 | Bhutan | 386 | 258 | 57 | 46 | 748 | 844 | 637 | 1,325 |
| 8 | Bosnia and Herzegovina | 7,108 | 2,406 | 449 | 1,010 | 10,972 | 9,949 | 3,907 | 2,546 |
| 9 | Cape Verde | 438 | 18 | 201 | 252 | 908 | 983 | 507 | 1,940 |
| 10 | Comoros | 95 | 14 | 45 | 39 | 193 | 387 | 600 | 645 |
| 11 | Equatorial Guinea | 2,109 | 7,136 | 1,484 | 51 | 10,780 | 6,416 | 504 | 12,742 |
| 12 | Ethiopia | 4,127 | 903 | 1,178 | 789 | 6,997 | 11,174 | 71,256 | 157 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 13 | Iran, Islamic Rep. of | 38,238 | 56,252 | ... | ... | 94,490 | 189,784 | 68,251 | 2,781 |
| 14 | Iraq | 23,430 | 24,096 | ... | ... | 47,526 | 12,602 | ... | ... |
| 15 | Kazakhstan | 17,353 | 27,849 | 7,404 | 2,019 | 54,624 | 57,124 | 15,146 | 3,772 |
| 16 | Lao People's Dem. Rep. | 809 | 506 | ... | ... | 1,315 | 2,875 | 5,924 | 485 |
| 17 | Lebanon | 9,633 | 2,337 | 7,838 | 10,740 | 30,548 | 21,944 | 3,577 | 6,135 |
| 18 | Liberia | 324 | 131 | ... | ... | 455 | 548 | 3,283 | 167 |
| 19 | Libyan Arab Jamahiriya | 7,000 | 30,110 | 2,128 | 419 | 39,657 | 38,756 | 5,853 | 6,621 |
| 20 | Russian Federation | 125,303 | 243,569 | 38,465 | 24,435 | 431,772 | 763,720 | 143,114 | 5,336 |
| 21 | Samoa | 187 | 12 | 51 | 111 | 361 | 404 | 185 | 2,184 |
| 22 | Sao Tomé and Principe | 50 | 3 | 23 | 18 | 93 | 71 | 157 | 451 |
| 23, 24 | Serbia and Montenegro | 11,635 | 5,065 | 1,478 | 1,909 | 20,088 | 26,215 | 8,064 | 3,251 |
| 25 | Seychelles | 676 | 340 | 251 | 346 | 1,613 | 694 | 84 | 8,209 |
| 26 | Sudan | 6,757 | 4,824 | 1,801 | 101 | 13,482 | 27,542 | 36,233 | 760 |
| 27 | Syrian Arab Republic | 9,520 | 8,708 | 2,136 | 2,827 | 23,191 | 26,320 | 19,043 | 1,382 |
| 28 | Tajikistan | 1,330 | 909 | 250 | 103 | 2,592 | 2,312 | 6,507 | 355 |
| 29 | Ukraine | 36,136 | 34,287 | 6,962 | 8,913 | 86,298 | 82,876 | 47,075 | 1,761 |
| 30 | Uzbekistan | 3,666 | 4,749 | 425 | 660 | 9,500 | 13,951 | 26,167 | 533 |
| 31 | Vanuatu | 140 | 39 | 68 | 104 | 352 | 341 | 211 | 1,611 |
| 32 | Yemen | 4,865 | 6,380 | 1,103 | 285 | 12,632 | 15,066 | 20,975 | 718 |
| | Total (absolute) | 357,340 | 528,130 | 81,929 | 62,022 | 1,029,421 | 1,470,156 | 538,602 | 2,708 |
| | Total (% world) | 3.3% | 5.0% | 3.6% | 2.6% | 4.0% | 3.3% | 8.4% | |
| Total WTO Members (151) | | | | | | | | | |
| | Total (absolute) | 10,366,756 | 9,927,533 | 2,223,895 | 2,362,966 | 24,881,150 | 42,984,728 | 5,789,786 | 7,424 |
| | Total (% world) | 96.6% | 94.9% | 96.4% | 97.4% | 96.0% | 96.7% | 90.9% | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Total WTO and Acceders (183) | | | | | | | | | |
| | Total (absolute) | 10,724,096 | 10,455,663 | 2,305,824 | 2,424,988 | 25,910,571 | 44,454,885 | 6,328,387 | 7,025 |
| | Total (% world) | 99.9% | 99.9% | 100.0% | 100.0% | 99.9% | 100.0% | 99.3% | |
| UN Member-States outside the WTO system (13) | | | | | | | | | |
| 1 | Eritrea | 495 | 10 | ... | ... | 505 | 970 | 4,401 | 220 |
| 2 | Kiribati | 74 | 4 | ... | ... | 78 | 76 | 99 | 772 |
| 3 | Korea, Dem. People's Rep. of | 2,718 | 1,338 | ... | ... | 4,056 | ... | 22,488 | ... |
| 4 | Marshall Islands | 95 | 16 | ... | ... | 111 | 144 | 63 | 2,282 |
| 5 | Micronesia (Fed. States of) | 137 | 20 | ... | ... | 157 | 232 | 110 | 2,097 |
| 6 | Monaco | ... | ... | ... | ... | ... | ... | 33 | ... |
| 7 | Nauru | ... | ... | ... | ... | ... | ... | ... | ... |
| 8 | Palau | 98 | 6 | ... | ... | 104 | 145 | 20 | 7,197 |
| 9 | San Marino | ... | ... | ... | ... | ... | 900 | 28 | 31,915 |
| 10 | Somalia | ... | ... | ... | ... | ... | ... | 8,228 | ... |
| 11 | Timor-Leste | ... | ... | ... | ... | ... | 349 | 976 | 358 |
| 12 | Turkmenistan | 3,588 | 4,935 | ... | ... | 8,523 | 8,067 | 4,833 | 1,669 |
| 13 | Tuvalu | 13 | 0 | ... | ... | 13 | ... | ... | ... |
| | Total (absolute) | 7,218 | 6,329 | ... | ... | 13,547 | 10,883 | 41,280 | 827 |
| | Total (% world) | 0.1% | 0.1% | ... | ... | 0.1% | 0.0% | 0.7% | |
| | WORLD TOTAL | 10,731,314 | 10,461,992 | 2,305,824 | 2,424,988 | 25,924,118 | 44,465,667 | 6,369,668 | |

Source: WTO Secretariat, using the WTO Statistics Database; World Bank, World Development Indicators and National Income Statistics of Chinese Taipei.

## Notes:

Total merchandise trade is defined according to the general trade definition, which includes trade flows in regard to warehoused and re-exported goods. It covers all types of inward and outward movement of goods through a country or territory including movements through customs warehouses and free zones. Goods include all merchandise that either add to or reduce the stock of material resources of a country or territory by entering (imports) or leaving (exports) the country's economic territory.

The EC(22) total refer to the sum of the individual member States and do not include adjustment for under-recorded intra-EC imports due to the Intrastate system of collecting trade statistics.

Extra-EC(22) is the difference between the total and intra trade of EC(22).

World (total) is the sum of the above statistics. It is calculated on the basis of total EC trade (intra plus extra) and the import figure is not adjusted for under-recorded intra-EC imports.

Commercial services: In the fifth edition of the Balance of Payments Manual, the current account is subdivided into goods, services (including government services, n.i.e.), income (investment income and compensation of employees), and current transfers. The commercial services category in this report is defined as being equal to services minus government services, n.i.e. Commercial services is further sub-divided into transport, travel, and other commercial services

GDP (current US$): GDP at purchaser's prices is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Data are in current U.S. dollars. Dollar figures for GDP are converted from domestic currencies using single year official exchange rates. For a few countries where the official exchange rate does not reflect the rate effectively applied to actual foreign exchange transactions, an alternative conversion factor is used.

Population: Total population is based on the de facto definition of population, which counts all residents regardless of legal status or citizenship—except for refugees not permanently settled in the country of asylum, who are generally considered part of the population of their country of origin.

Symbols
... = not available
\- = not applicable

## Annex 4 TIMELINE FOR COMPLETED ACCESSIONS

In order of date of WTO accession.

| | Ecuador | | Bulgaria | | Mongolia | | Panama | | Kyrgyz Republic | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo |
| Application | 09/1992 | | 09/1986 | | 07/1991 | | 08/1991 | | 02/1996 | |
| Working Party Established | 10/1992 | | 02/1990 | | 10/1991 | | 10/1991 | | 04/1996 | |
| Memorandum | 05/1993 | | 07/1993 | | 01/1992 | | 06/1993 | | 08/1996 | |
| 1st Meeting of Working Party | 07/1993 | 2 months | 07/1993 | 1 month | 06/1993 | 1 year 5 months | 04/1994 | 10 months | 03/1997 | 7 months |
| Draft Working Party Report | 10/1994 | 1 year 5 months | 05/1994 | 10 months | 12/1994 | 2 years 11 months | 05/1996 | 2 years 11 months | 04/1998 | 1 year 8 months |
| Report Adopted by Working Party | 07/1995 | 2 years 2 months | 09/1996 | 2 years 2 months | 06/1996 | 4 years 5 months | 09/1996 | 2 years 3 months | 07/1998 | 1 year 11 months |
| Report Adopted by Council | 07/1995 | 2 years 2 months | 10/1996 | 3 years 3 months | 07/1996 | 4 years 6 months | 10/1996 | 3 years 4 months | 10/1998 | 2 years 2 months |
| Membership | 01/1996 | 2 years 8 months | 12/1996 | 3 years 5 months | 01/1997 | 5 years | 09/1997 | 4 years 3 months | 12/1998 | 2 years 4 months |
| Total Time | 3 years 4 months | | 10 years 3 months | | 5 years 6 months | | 5 years 1 month | | 2 years 10 months | |

| | Latvia | | Estonia | | Jordan | | Georgia | | Albania | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo |
| Application | 11/1993 | | 03/1994 | | 01/1994 | | 07/1996 | | 11/1992 | |
| Working Party Established | 12/1993 | | 03/1994 | | 01/1994 | | 07/1996 | | 12/1992 | |
| Memorandum | 08/1994 | | 03/1994 | | 10/1994 | | 07/1997 | | 01/1995 | |
| 1st Meeting of Working Party | 03/1995 | 7 months | 11/1994 | 8 months | 10/1996 | 2 years | 03/1998 | 11 months | 04/1996 | 1 year 3 months |
| Draft Working Party Report | 12/1996 | 2 years 4 months | 11/1998 | 4 years 8 months | 04/1999 | 4 years 6 months | 02/1999 | 1 year 10 months | 07/1999 | 4 years 6 months |
| Report Adopted by Working Party | 09/1998 | 4 years 1 month | 04/1999 | 5 years 1 month | 11/1999 | 5 years 1 month | 10/1999 | 2 years 6 months | 07/2000 | 5 years 6 months |
| Report Adopted by Council | 10/1998 | 4 years 2 months | 05/1999 | 5 years 2 months | 12/1999 | 5 years 2 months | 10/1999 | 2 years 6 months | 07/2000 | 5 years 6 months |
| Membership | 02/1999 | 4 years 6 months | 11/1999 | 5 years 8 months | 04/2000 | 5 years 6 months | 06/2000 | 3 years 2 months | 09/2000 | 5 years 8 months |
| Total Time | 5 years 3 months | | 5 years 8 months | | 6 years 4 months | | 4 years 1 month | | 7 years 10 months | |

| | Oman | | Croatia | | Lithuania | | Moldova | | China | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo |
| Application | 04/1996 | | 09/1993 | | 01/1994 | | 11/1993 | | 07/1986 | |
| Working Party Established | 06/1996 | | 10/1993 | | 02/1994 | | 12/1993 | | 03/1987 | |
| Memorandum | 06/1996 | | 06/1994 | | 12/1994 | | 12/1996 | | 02/1987 | |
| 1st Meeting of Working Party | 04/1997 | 10 months | 04/1996 | 1 year 10 months | 11/1995 | 11 months | 06/1997 | 6 months | 10/1987 | 8 months |
| Draft Working Party Report | 03/1999 | 2 years 9 months | 08/1998 | 2 years 2 months | 06/1997 | 2 years 6 months | 07/1999 | 2 years 7 months | 12/1994 | 7 years 10 months |
| Report Adopted by Working Party | 09/2000 | 3 years | 06/2000 | 6 years 3 months | 10/2000 | 5 years | 12/2000 10 months | 4 years | 09/2001 | 14 years 7 months |
| Report Adopted by Council | 10/2000 | 3 years | 07/2000 | 6 years 4 months | 12/2000 | 6 years 1 month | 05/2001 | 4 years 5 months | 11/2001 | 14 years 9 months |
| Membership | 11/2000 | 3 years 5 months | 11/2000 | 6 years 5 months | 05/2001 | 6 years 5 months | 07/2001 | 4 years 7 months | 12/2001 | 14 years 10 months |
| Total Time | 4 years 7 months | | 7 years 2 months | | 7 years 5 months | | 7 years 4 months | | 15 years 5 months | |

| | Chinese Taipei | | Armenia | | FYROM | | Nepal | | Cambodia | | Saudi Arabia | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo | Date | Time Since Memo |
| Application | 01/1992 | | 11/1993 | | 12/1994 | | 05/1989 | | 12/1994 | | 06/1993 | |
| Working Party Established | 09/1992 | | 12/1993 | | 12/1994 | | 06/1989 | | 12/1994 | | 07/1993 | |
| Memorandum | 10/1992 | | 04/1995 | | 04/1999 | | 08/1998 | | 06/1999 | | 07/1994 | |
| 1st Meeting of Working Party | 11/1992 | 1 month | 01/1996 | 9 months | 07/2000 | 1 year 3 months | 05/2000 | 1 year 9 months | 05/2001 | 1 year 11 months | 05/1996 | 1 year 10 months |
| Draft Working Party Report | 03/1998 | 5 years 5 months | 03/1997 | 1 year 11 months | 05/2002 | 2 years 11 months | 06/2003 | 4 years 10 months | 03/2003 | 3 years 9 months | 01/2000 | 5 years 6 months |
| Report Adopted by Working Party | 09/2001 | 8 years 11 months | 11/2002 | 6 years 7 months | 09/2002 | 3 years 5 months | 08/2003 | 5 years | 07/2003 | 4 years 1 month | 10/2005 | 11 years 3 months |
| Report Adopted by Council | 11/2001 | 9 years 1 months | 12/2002 | 6 years 8 months | 10/2002 | 3 years 6 months | 09/2003 | 5 years 1 month | 09/2003 | 4 years 3 months | 11/2005 | 11 years 4 months |
| Membership | 01/2002 | 9 years 2 months | 02/2003 | 6 years 10 months | 04/2003 | 4 years | 04/2004 | 5 years 8 months | 10/2004 | 5 years 4 months | 12/2005 | 11 years 5 months |
| Total Time | 10 years | | 9 years 3 months | | 8 years 3 months | | 14 years 11 months | | 9 years 10 months | | 12 years 6 months | |

| | Viet Nam | | Tonga | |
|---|---|---|---|---|
| | Date | Time Since Memo | Date | Time Since Memo |
| Application | 01/1995 | | 06/1995 | |
| Working Party Established | 01/1995 | | 11/1995 | |
| Memorandum | 09/1996 | | 05/1998 | |
| 1st Meeting of Working Party | 07/1998 | 1 year 10 months | 04/2001 | 2 years 11 months |
| Draft Working Party Report | 11/2004 | 8 years 2 months | 03/2003 | 4 years 10 months |
| Report Adopted by Working Party | 10/2006 | 10 years 1 month | 12/2005 | 7 years 7 months |
| Report Adopted by Council | 11/2006 | 10 years 2 months | 12/2005 | 7 years 7 months |
| Membership | 01/2007 | 10 years 4 months | 07/2007 | 9 years 2 months |
| Total Time | 12 years | | 12 years 1 month | |

Source : WTO

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# Chapter 03

# Comment and Advice for Trade Remedy Legislations and Policies: Based on Korea's Experience

1_ Introduction: Devising a Mechanism to Protect the Domestic Market Legitimately in the WTO
2_ Basic Guidelines for the Adoption of Trade Remedy Measures
3_ Suggestion for Specific Projects to be Implemented
4_ Korea's Experience
5_ Other Potentially Critical Issues
6_ Conclusion

Chapter 03

# Comment and Advice for Trade Remedy Legislations and Policies: Based on Korea's Experience

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## 1. Introduction: Devising a Mechanism to Protect the Domestic Market Legitimately in the WTO Regime

Acceding to the World Trade Organization ("WTO") certainly invites new challenges for the applying new Member in various areas. These challenges are simply tremendous, both in quantity and in quality. The WTO membership basically means opening up the new Member's domestic market to the imports from other Members. At the same time, joining the WTO also provides a legitimate mechanism to protect domestic markets from the "unfair" foreign trade as long as the protection is implemented within the boundary of the rules of the WTO Agreements. So, in a sense, the accession comes in a package of both challenges and opportunities; challenges as the new Member must open up its domestic markets and compete with foreign imports on equal footing, and opportunities as it can also penetrate markets of the other Members while protecting its domestic market in a particular manner. The question is how to minimize the challenges and how to maximize the opportunities.

The WTO Agreements explicitly acknowledges that sometimes a Member needs to protect its domestic market from the penetration of foreign trade: they allow a Member to respond to "unfair" trade from other Members through antidumping investigations (in case of dumping activity by foreign companies) and countervailing duty investigations (in case of subsidies given to the foreign companies by the foreign governments)[1]; they also allow a Member to respond to

1. See Article 2 of Antidumping Agreement and Article 1 of the SCM Agreement.

an unexpected surge of imports from other countries even when the surge was a result of fair trade (in case of safeguards investigation).[2] These three measures are collectively called "trade remedy" under the WTO regime. So, this paper also uses the term "trade remedy" to refer to antidumping measures, countervailing measures and safeguards measures, collectively, that are adopted by a Member of the WTO to deal with unfair and fair trade. Establishing an effective mechanism to administer the trade remedy measures, therefore, is a prerequisite to handle the penetration of imports from other Members and this is one of the key tasks to make the accession a success on the part of the new Member.

The utilization of trade remedy measures, however, requires a careful consideration and thorough preparation in advance. The preparation takes a lengthy amount of time and cannot be done overnight, unlike almost all other issues on the accession negotiation tables which would usually require decisions mainly flowing from political determinations and willingness in the leadership. The establishment and administration of the trade remedy measures are, on the other hand, based on legal principles and require a legalistic approach. The operation of these measures are conducted through a judicial process, both in the domestic level (conducted by the IA of a Member) and in the international level (conducted by the WTO Dispute Settlement Body).

As such, the WTO Members are required to provide domestic laws and regulations properly, administer those laws and regulations fairly, and reach a determination reasonably. Furthermore, the WTO Agreements relating to trade remedy measures require Members to adopt key legislations and regulations that are necessary to administer trade remedy mechanism in a manner consistent with provisions of the agreements.[3] If one Member fails to adopt these laws and regulations in the first place, that would directly constitute violation of the WTO ("as such" violation). If a Member fails to apply the measure in a manner inconsistent with the WTO Agreements even if the laws and regulations are properly stipulated, that would also constitute violation ("as applied" violation). It is critical, therefore, that a new Member ensures the following two things: (i) put proper laws and regulations in place and (ii) find a way to implement these laws and regulations in a proper manner. Needless to say, this will probably turn out to be a daunting task for a new Member that must accomplish these projects almost instantly. The WTO Agreements are composed of hundreds of pages of legal documents that lay out detailed norms. Every move of the new Member in trade remedy measures would be closely watched by existing Members, who have gone through this process already and who are in a position to monitor the compliance of the new Member.

Government of Azerbaijan ("GOA") is thus advised to be aware of these aspects

2. See Article 2 of the Safeguards Agreement.
3. See, e.g. Article 1 of the Antidumping Agreement, Article 14, of the SCM Agreement.

surrounding the trade remedy measures and initiate the preparation process in a more comprehensive manner. As will be explained below, this process requires more than simple enactment of some key legislations. It requires more strategic thinking in various fronts, including consideration in structural reorganization of government agencies, coordination of relevant statues, awareness of due process requirements in the administration of governmental measures, restructuring of the judicial organs, etc. This process requires a multi-dimensional thinking for a lengthy amount of the time into the future.

# 2. Basic Guidelines for the Adoption of Trade Remedy Measures

In contemplating the adoption of the trade remedy measures, the GOA may consider the following basic guidelines. These guidelines may assist the GOA in specifically formulating rules and policies in the area of trade remedy measures.

## 2.1 Maintain Consistency with WTO Agreements

Laws and regulations to be adopted by the GOA are to be in full compliance with the WTO norms. To the extent possible, the laws and regulations should clearly stipulate rights and obligations of the GOA as much as possible. Avoiding ambiguous expressions and provisions would help the GOA move in the right direction down the road and would reduce the possibility of the WTO legal challenges, both "as applied" and "as such." At the same time, as will be explained below, the GOA needs to make sure that it maintains discretion of the IA to the extent permitted by the WTO Agreements. In other words, it may try to adopt clear and unambiguous languages but at the same time it may preserve necessary discretion for the IA. This is critical since discretion for the IA officials is indispensable in carrying out actual investigations effectively and properly.

This process requires prior study of the relevant WTO Agreements with respect to trade remedy measures; namely, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Antidumping Agreement"), Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), and Agreement on Safeguards ("Safeguards Agreement"). For instance, the underlying themes of the Antidumping Agreement for IAs of all Members would be that all the IAs have to make sure to establish a sufficient factual basis of positive evidence necessary to support a WTO-consistent finding of dumping by objectively assessing the information collected in the course of the investigations. The conclusions of the

IAs, therefore, should be reasoned, and the evidence they develop should support a WTO-consistent determination that the alleged dumping did take place. In addition, Articles 2.4, 2.4.2, 9.3, 11.1, 11.2 and 11.3 of the Antidumping Agreement lay out legal guidelines for IAs of the Members in calculating dumping margins in antidumping investigations or subsequent reviews. Likewise, Article 6 of the Antidumping Agreement stands for the proposition that any investigation or review conducted by an IA must observe the due process principle. All these principles and underlying themes need to be taken into account by the Members in legislating laws and regulations in a WTO- consistent manner. The GOA therefore is also required to carefully review these three trade remedy agreements to identify their underlying objectives and themes as the first step of the legislative process.

Likewise, the effort to keep the laws and regulations consistent with the WTO Agreements also requires reference to and consideration of the relevant jurisprudence as pronounced by the WTO's Dispute Settlement Body. The GOA probably does not have the resources to accomplish this at this time, but it will have to ultimately. These precedents would tell the GOA as to how relevant provisions of the Antidumping Agreement, the SCM Agreement and the Safeguards Agreement are to be construed in accordance with the ordinary meaning of those provisions in the agreements consistently with their context, object and purpose. This would also guide the GOA in its challenging legislative process as well.

In the draft legislation of the GOA, however, there seems to be some discrepancies between the proposed provisions and relevant provisions of the WTO Agreements. For instance, Article 27 of the draft statute provides for exclusion of certain subsidies from the countervailing measures. As it currently stands, the SCM Agreement does not provide categorical exemption for certain types of subsidies. Therefore, such an approach may unnecessarily bind the hands of the GOA. In any event, it does not seem clear why the GOA has decided to exempt these subsidies from the countervailing measures, so the rationale needs to be checked before finalized.

## 2.2 Maintain Discretion of the IA

Another basic guideline in establishing the trade remedy measures is that the GOA needs to be careful not to unnecessarily restrict the IA's legitimate authority. Simply stated, there is no reason to impose more restriction on the IA than is required by the WTO Agreements. As long as the legislations and regulations stay within the WTO Agreements, they usually do not create a legal problem unless and until they are applied in a WTO-inconsistent manner in a particular investigation. Maintaining discretion could be important because the IA of the GOA will be likely to encounter various practical difficulties in the actual setting. Ensuring a sufficient maneuvering room for the IA would be quite helpful in dealing with these practical difficulties,

particularly in the early stage of the operation.

For instance, the WTO Agreements do not impose any specific obligation as to how to formulate a specific measure to secure the payment of various duties and associated fees. A Member therefore could exercise its discretion in formulating specific operating mechanism of the payment system once an antidumping duty is imposed as a result of an antidumping investigation. In these areas, unless there is any compelling reason, there does not seem to be any particular reason to follow the examples of the other advanced countries, such as the United States or the European Communities, who have accumulated significant amount of experience and whose situation would be significantly different from that of Azerbaijan. Their systems may obviously be more advanced and detailed, but it is a different question whether such a system would be beneficial to Azerbaijan at this particular stage.

Of course, exercising discretion in a way that ignores an explicit provision, however, would lead to violation of the relevant agreement. For instance, under Article 61 of the Agreement on Trade Related Intellectual Property Rights ("TRIPs"),[4] a Member is required to adopt an effective criminal enforcement mechanism for the IPR violators in the domestic market. It may well be true that a Member has discretion in carrying out this particular provision domestically as to how to administer its criminal enforcement system internally. But the situation would be completely different if a certain category of IPR crimes simply go unpunished. In this case, it is not about discretion any more, but about deviation from a treaty obligation. In this regard, provisions of the 1969 Vienna Convention on the Law of Treaties are frequently referred to. Article 26 of the Vienna Convention provides that a party to a treaty assumes the obligation to implement the obligation of the treaty "in good faith.[5]" In addition, Article 27 of the convention further provides that a party to a treaty cannot rely on domestic regulation or legislation to justify violation of its treaty obligation.[6] This jurisprudence has also been consistently confirmed by various decisions of international tribunals[7] and the WTO Dispute

4. Although TRIPs is not directly related with trade remedy measures, recent disputes concerning TRIPs (such as *China-Measures Affecting the Protection and Enforcement of Intellectual Property Rights* (DS362)) have featured the proper delineation between a Member's discretion flowing from national sovereignty and obligation arising under the agreement.
5. Article 26 of the Vienna Convention provides that:
   *"Pacta sunt servanda"*
   Every treaty in force is binding upon the parties to it and must be performed by them in good faith.
6. Article 27 of the Vienna Convention provides that:
   *Internal law and observance of treaties*
   A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty:
7. *ee, e.g.,* Concerning Factory at Chorzów (Claim for Indemnity) (The Merits) (F.R.G. v Pol.), 1928 P.C.I.J. (ser. A) No. 17, at 4-65 (Sept. 1928); Concerning Rights of Nationals of the United States in Morocco, (Fr. v. U.S.) 1952 I.C.J. 176 (Aug. 27); Free Zones of Upper Savoy and the District of Gex, (Fr. v. Switz.), 1932 P.C.I.J. (ser. A) No. 22, at 12-21.

Settlement Body.[8]

Another area that would be relevant in maintaining discretion of the IA is the application of the standard of "facts available." This is one of the most potent tools for any IA. The IA is authorized to punish any non-cooperative foreign respondent in an antidumping investigation or a countervailing duty investigation by resorting to information that would not be favorable to the foreign respondent, thereby raising the final margin. For instance, Article 6.8 of the Antidumping Agreement provides that:

> 6.8 In cases in which any interested party refuses access to, or otherwise does not provide, necessary information *within a reasonable period* or *significantly impedes* the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available. *The provisions of Annex II shall be observed in the application of this paragraph.* (emphasis added).

The IA of the GOA is allowed to warn any non-cooperating foreign respondent in an investigation by referring to this provision. Unless the foreign respondent is ready to give up the Azerbaijani market, most of the time the respondent is forced to cooperate. So, this would be an effective mechanism for the GOA IA in an actual investigation. At the same time, the GOA should keep in mind that there is Lan outer boundary for the application of the facts available standard. Paragraphs 3 and 6 of Annex II of the Antidumping Agreement thus provide that:

> 3. *All information which is verifiable, which is appropriately submitted so that it can be used in the investigation without undue difficulties, which is supplied in a timely fashion*, and, where applicable, which is supplied in a medium or computer language requested by the authorities, should be taken into account when determinations are made. (emphasis added).
>
> 6. If evidence or information is not accepted, *the supplying party should be informed forthwith of the reasons therefore*, and should have an *opportunity to provide further explanations within a reasonable period*, due account being taken of the time-limits of the investigation. (emphasis added).

Thus, these provisions make clear that the Antidumping Agreement does not provide a carte blanche to an IA conducting an antidumping investigation whenever it encounters a less than

8. UNITED STATES - SECTIONS 301-310 OF THE TRADE ACT OF 1974 *Report of the Panel*, WT/DS152/R, 22 December 1999 footnote 652; UNITED STATES - IMPORT MEASURES ON CERTAIN PRODUCTS FROM THE EUROPEAN COMMUNITIES, Report of the Panel, WT/DS165/R 17 July 2000, para 6.81; MEXICO - MEASURES AFFECTING TELECOMMUNICATIONS SERVICES, Report of the Panel, WT/DS204/R, 2 April 2004, para. 7.244

optimal information from a foreign respondent. Instead, these provisions unequivocally provide conditions that need to be satisfied before the IA applies the facts available standard. Paragraph 3 stipulates that all verifiable information that can be used in the investigation without undue difficulties should be taken into account by the IA. Paragraph 6, in turn, stipulates that if the IA plans to apply facts available, it must inform the foreign respondent of the reason and offer it another opportunity to provide the requested information within a reasonable period of time. Other than these general guidelines, an IA has quite a wide discretion in evaluating the level of cooperation and the necessity to apply the facts available standard. In addition, from the practical standpoint, the application of the facts available standard tend to make an investigation easier for the IA, so if at all possible, there is no reason for the GOA IA to refrain from utilizing this standard.

The GOA, therefore, is advised to devise an investigating procedure, through legislations or regulations, where it can exercise full discretion in applying "facts available." But at the same time, these legislations and regulations need to guarantee that such an application stays within the Antidumping Agreement and the SCM Agreement.

## 2.3. Focus on Procedural Aspect

At the same time, it is critical that the GOA should not lose its focus on procedural aspects of trade remedy measures administration. As the WTO Agreements take a more legalistic approach as a result of the Uruguay Round negotiations (and possibly currently on-going Doha Round negotiations), procedural aspects of the investigation has also become an equally important element in a trade remedy measure administration.[9] The emphasis on procedural rules in this process has also led to the incorporation of various procedural rules from the "common law" system states rather than continental legal system states such as Korea or Azerbaijan.[10]

9_ One scholar has once stated that:

> The rise and development of procedural rules in anti-dumping cases in GATT/WTO is part of a larger movement in the general GATT/WTO jurisprudence and structures. This movement is sometimes identified as a move towards legalism in the regulation of world economy, a move from diplomacy to rule-based trade regulatory framework, sometimes as a process of judicialization.... The procedural review and transparency movement in WTO antidumping jurisprudence is a brand new phenomenon in the area of international regulation of world economy. It makes the WTO rules and its adjudication more like a code of international administrative law.

Dongsheng ZANG, *Seeking Transparency in Antidumping Actions through Procedural Review: The GATT/WTO Jurisprudence and Its Implications for China (Part II)*, Perspectives, Vol. 2, No. 6 (available from http://www.oycf.org/perspectives/12_063001/seeking_transparency_II.htm)

10. Id. ("As far as procedure is concerned, there seems to be a subtle move from Continental inquisitional to adversary form of adjudication.")

In the Antidumping Agreement, procedural guidelines mainly appear in Article 6 of the agreement, although there are other relevant provisions as well. It should also be noted that the obligations under these Articles also apply to administrative reviews and sunset reviews as well. By way of example, Article 11.4 of the Antidumping Agreement provides that "[t]he provisions of Article 6 regarding evidence and procedure shall apply to any review carried out under this Article." The Appellate Body has also confirmed that "claims under Article 6 may be made in relation to sunset review determinations on the basis of the cross-reference to Article 6 found in Article 11.4."[11] So, all the obligations contained in Article 6 apply to original antidumping investigation, its administrative review and sunset review with equal force. All these obligations contained in Article 6 collectively stand for the proposition that fundamental due process rights must be ensured at all times in these procedures.[12] Any investigation or review to be conducted by the GOA should therefore be in compliance with these provisions of the Antidumping Agreement and be procedurally appropriate. The same is also true with respect to countervailing duty investigations under the SCM Agreement and safeguards investigations under the Safeguards Agreement.

As such, in a prospective antidumping investigation, if the IA of the GOA somehow fails to provide the interested parties with meaningful opportunities to present in writing all evidence which they consider relevant, fails to provide interested parties with a full opportunity for the defense of their interests, fails to provide timely opportunities for interested parties to review all information that was relevant to the presentation of their cases, fails to satisfy the requirements to provide non-confidential summaries of confidential information, fails to satisfy the requirements to ensure the accuracy of information that is relied on to the exclusion of other more probative evidence, fails to follow the requirements of facts available; or fails to inform interested parties of the essential facts under consideration that formed the basis for the decision, they all constitute, either individually or collectively, violations of Articles 6 and 11 of the Antidumping Agreement.

Another obvious example in this regard would be rampant incident of ex parte contacts, which are not uncommon in many developing countries.[13] These contacts are usually strictly prohibited or regulated in other countries. This could directly undermine the fairness of an investigation or determination. This should be avoided as much as possible by the IA of the GOA. In addition, the GOA should officially acknowledge the right of appeal for the parties involved in antidumping or the countervailing duty investigations. This also sometimes takes a

11. U.S.-OCTG from Argentina (AB), para. 239.
12. U.S.-OCTG from Argentina (AB), para. 241; Guatemala - Definitive Anti-Dumping Measures on Grey Portland Cement from Mexico, WT/DS156/R, adopted 17 November 2000, para. 8.119; United States - Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan, WT/DS244/R, adopted 9 January 2004, para. 7.255.
13. David R. Grace, Alexia Herwig, & Yao Feng, China's Antidumping Regime, supra note 43.

long time. In the case of China, which acceded to the WTO in 2001, only in December 2004 did the Supreme People's Court of China rule that importers and exporters could challenge either administratively or judicially government decisions relating to antidumping and anti-subsidy measures. Needless to say, checking and fine-tuning all these procedural hurdles would be a daunting task for the IA of the GOA in the initial stage of the accession.

In sum, it would be necessary for the GOA to establish a mechanism to guarantee procedural fairness and transparency in practice. An "Antidumping Investigation Manual" would help standardize the antidumping investigations, and provide an emotional safety-net for the officials of the GOA, who will have to deal with actual investigations. Procedural issues are as important and meaningful as substantive issues in an actual trade remedy investigation.

## 2.4. Consider DDA Negotiations

The GOA is also advised to closely monitor development in the currently on-going Doha Development Agenda ("DDA") negotiations, where various suggestions and proposals to improve the current Antidumping Agreement, the SCM Agreement and the Safeguards Agreement are discussed. The outcome of this negotiation could change the current trade remedy agreements considerably and thus may affect the GOA as such. Particularly, any change to the Dispute Settlement Understanding ("DSU") would entail changes to the trade remedy investigation mechanism as well. Thus, the GOA needs to pay keen attention to the development of these negotiations.

According to the proposals currently debated, in some areas, IAs of Members would be more regulated more than the current regime while in other areas they would have more of a leeway. In the course of bilateral negotiations with key trading partners this year and enacting legislations and regulations this year and next year, this DDA factor should be taken into account by the GOA.

## 2.5. Consider Feasibility in Actual Application

The GOA is also advised to approach these issues from the "practical" standpoint. An impeccable legislation or regulation does not necessarily mean that it could actually operate as designed. If the provisions of the legislation and regulation fail to adequately reflect the reality of the GOA, they would simply turn out to be yet another legal ground for other Members to find alleged violation of its own domestic laws by the GOA. In this regard, each provision should be examined on the basis of the feasibility test. If the feasibility test does not prove that the GOA can actually implement a particular provision, a remedial measure should be done as

soon as possible (if it is a mandatory requirement under the WTO Agreements) or an adequate level of discretion should be preserved (if it is not a mandatory requirement under the WTO Agreements).

At the same time, most new Members seem not to sufficiently consider the practical aspect of the IA operation. For instance, it would be easy to state in the legislation that "a final determination should be rendered in 240 days after the investigation is initiated." But the still remaining practical question is how the final determination is "rendered" by the IA. One could argue that it means that the IA makes its internal decision by that date. One could also argue that it means the decision is notified to all the interested parties by that date. One could further argue that it means the date when the decision is officially published. Depending on the interpretation we choose, there may be a significant difference in the number of days in actual investigations. All these practical aspects should somehow be examined by the GOA down the road.

## 3. Suggestion for Specific Projects to Be Implemented

To begin with, it should be noted that the draft legislation and other materials show that the GOA has been faithfully implementing its WTO obligations so far. As such, this paper is not to criticize the GOA in any manner, but instead to look into the current status and discuss ways for further development in the future in this important area. Correct understanding on the trade remedy system under the WTO regime will lay the groundwork for stable and reliable operation of the IA of the GOA.

In fact, the effort of the GOA for the overall reform measures have been duly recognized. For instance, the Department of Commerce of the United States ("USDOC") once stated that:

> Azerbaijan's continued efforts to modernize and reform its economy into a market economy present both significant prospects and challenges. Many outdated laws have been replaced with modern legislation to encourage foreign investment, to protect intellectual property, to permit bankruptcies, and to rationalize the government's revenue collection policies.[14]

This statement shows that other countries are also well aware of the good faith efforts of the Azerbaijan for the legislative projects so far. Nonetheless, there are more complicated tasks to

14. http://www.buyusa.GOA/azerbaijan/en/azeics2008.html

be implemented by the GOA in the long run in this regard. The success or failure of the GOA in the legislative work including the work in the trade remedy sector pretty much depends on the work to be done from now on. The process has not ended with a couple of key legislations. In fact, it has just begun.

## 3.1. Finalizing Legislative Preparation

Generally speaking, joining the WTO requires significant change of the new Member's economic structure. To guarantee that the new Member changes its economic structure, the WTO requires introduction of new legislation and amendment of existing legislation. This usually is one of the most onerous tasks for any new Member. Tariffs and market opening conditions can all be completed at the time of accession (whether satisfactorily or reluctantly), but the legislative change requirement continues to haunt the country after the accession.

Needless to say, this is easier said than done. Amendment or adoption of law and regulation is an enormous, time-consuming task. China and Vietnam, two recent joining Members of the WTO, are still in the process of enacting new laws and regulations and amending existing ones. After 10 years of accession, Korea is still in the process of changing and adopting relevant laws and regulations. In fact, this is not merely a one-time measure, but an on-going project for all WTO Members. As it is an on-going project, it is critical that the first step is thrown in the right direction. Otherwise, it will have to come back to the starting line over and over again.

Furthermore, for all these laws and regulations to be newly introduced, they will have to be translated into English, at least gradually, which will also turn out to be a logistical difficulty for the GOA. Here again, earlier planning is necessary to spread out the workload and to let other Members and the WTO at least know that the GOA is making efforts in this respect.

The trade remedy sector is not an exception. All laws and regulations relating to the trade remedy sector need to be enacted in a way consistent with WTO norms. Some need to be done before the entry but most of them (particularly detailed parts) need to be done after the entry. If the GOA fails to carry out this in a reasonably short period of time, other countries will bring an action against the GOA any time once Azerbaijan becomes a Member. China provides a good example in this respect. The United States recently initiated a serious WTO challenge against China where it alleges that China is still failing to adopt necessary legislations for various WTO Agreements.[15] This legislative work will remain to be one of the most significant headaches for the GOA for the future

15. See China-Intellectual Property Rights (DS362) and China-Trading Rights (DS363).

What is more important to the GOA is that this WTO obligation is applicable not only to national law or statutes, but also to governmental regulations and directives adopted under such statutes and legislations, or adopted by the voluntary decisions of each ministry. In other words, legislation in this context is not simply confined to statutes and enactment by the National Assembly; it also includes regulations and directives that are adopted in accordance with the statutes. In fact, in most situations, it is governmental regulations and directives that are more important in actual practice. In that sense, governmental practice (not even appearing in the text) is also important and this should also be consistent with WTO obligations. This is also true in the trade remedy sector as well. Not only the legislation, but also any policy directives, guidelines, or bulletins, if there is any, need to be repealed, adjusted or created in accordance with the WTO norms. Under these circumstances, even if legislative amendment is completed, it is nonetheless likely that other countries will challenge the GOA "practice" at the WTO.

As already noted above, the full alignment cannot be done overnight, but at least it is necessary to initiate contemplating the long-term plan at this stage. This is also directly related to the basic plan on how and where to establish the IA. Legislative work should be planned ahead and implemented step-by-step.

Such preparation should be based on the strategy as to how to attain both vertical and horizontal coordination. Vertical coordination means coordination among legislations and those under the legislations (such as enforcement decrees, guidelines, manuals, practices) while horizontal coordination means coordination among different statutes, different enforcement decrees or different guidelines. This coordination would help minimize confusion, avoid repeated amendment, reduce possibility of complaints from other countries and foreign exporters, and avoid legal friction as much as possible.

As such, it is necessary for the GOA to prepare and enact laws and regulations with this ultimate coordination strategy in mind. That way, the GOA can contemplate early on which is stipulated in the law and which in the enforcement decree and so forth. The current draft, however, does not indicate that this type of preparation has been under way. Basic structure of trade remedy legislation could be illustrated as illustrated on the next page.

The full alignment of the entire set of statutes, regulations and practices in all governmental activities cannot be done in the near future. It certainly takes a long time, but at least it is necessary to change major laws as soon as possible. To this end, other than the adoption of new legislations and regulations for trade remedy measures, the most urgent task for the GOA would be to implement the following two things: (i) confirm what laws, regulations and practices are related to trade remedy measures are inconsistent with the WTO norms and need to be changed; and (ii) prioritize which ones should be changed first under the limited resources and time constraints.

**Structure of Trade Remedy Legislation**

Accomplishment of Legislative Changes

| Statutes | Enforcement Decree | Regulation | Gov't practice |
|---|---|---|---|
| Framework | Elaboration | Practicality | Guidelines |
| • Key requirements<br>• Main procedural elements<br>• Organizational Scheme<br>• Setting forth trade remedy measures | • Detailed provisions for substantive issues<br>• Detailed provisions for procedural issues<br>• Setting forth division of work among gov't<br>• Key definitions | • More detailed provisions<br>• Practical elements for actual operation<br>• Deadlines and forms<br>• Regulates daily operation | • Internal guidelines<br>• Code of conduct<br>• Invisible policies and understanding<br>• Traditional course of action |

### 3.1.1. Horizontal Coordination

Trade remedy measures are directly affected by the legislations and enforcement decrees that regulate the conduct of trade remedy investigations. At the same time, there are other legislations and enforcement decrees that also affect, directly or indirectly, trade remedy measures as well. For instance, customs related acts and regulations, court administration related acts and regulations, or legal services related acts and regulations also affect the trade remedy measures. It is critical, therefore, that these laws and regulations also be evaluated by the GOA and amended when found necessary to achieve full compliance.

By way of example, in the trade remedy measure legislation, one Member may stipulate that any decision of the IA to impose or not to impose a trade remedy measure should be subject to the judicial review. The fulfillment of the judicial review, however, can only be possible when the relevant other statutes (such as Court Organization Act) provides for jurisdiction and competency of a particular court for such measures. Likewise, one Member could stipulate in the trade remedy legislation that a foreign respondent is entitled to a refund in the case of overpayment of the duties, but if the other relevant acts (such as Customs Act) do not provide for the management of the duties and funds, a refund would be a virtual impossibility, unless a new budget is authorized by the National Assembly or by other competent national entities.

In the same context, if Azerbaijan has adopted a legal system where it incorporates international law (such as the WTO Agreements) directly into the domestic legal system without domestic implementing legislation (as is the case in Korea, Japan, etc), all these agreements and treaties become part of the Azerbaijani law and regulations the moment it becomes a party to them. In this case, it is very likely that there are conflicting domestic laws existing at the same time in Azerbaijan and it could be confusing for the GOA and the Azerbaijani court to sort out which comes first in this kind of situation. On the other hand, if Azerbaijan has adopted a legal system where it does not incorporate international law directly but always requires an implementing legislation (as is the case in the United States, the United Kingdom), then these problems do not arise. In this case, however, a more immediate legislation of implementing statutes and regulations would be expected by other trading partners. Otherwise, the GOA may remain in violation of the treaties or agreements due to the omission.

All these issues could arise from outside of the trade remedy legislations per se. To address these problems, therefore, horizontal coordination among these laws and regulations will be ultimately necessary. The GOA should consider strategies to horizontally coordinate these various non-trade remedy laws and regulations as well as trade remedy laws and regulations.

### 3.1.2. Vertical Coordination

Once the statutes are finalized, all other subsidiary domestic rules (such as enforcement decrees, guidelines, ordinances and practices) should be aligned in accordance with the statutes. The level of details may go deeper as we go down the hierarchy, but the general direction and underlying themes should remain in the same direction. The other way around (that is, from bottom to top) would create more confusion and leads to continuing amendment of statutes which may not be necessarily easy.

Vertical coordination in the trade remedy sector could be done relatively easily by the Ministry of Economic Development. More difficult tasks would be how to guide other ministries and agencies to move along in the right direction in the areas where they are respectively in charge. In this process, therefore, it would be efficient if the Ministry of Economic Development finalizes the framework statutes as soon as possible containing sufficient guidelines for other ministries and agencies to follow. Then they can use these guidelines as reference materials in further enactment of enforcement decrees and guidelines in their respective areas. If each government agency remains sort of free to adopt enforcement regulation within the boundary of its own jurisdiction, it could cause disruption and inefficiency in future legislative process.

### 3.1.3. Problems of Practices and Custom

Trade remedy measure administration is directly related to the administration of customs office and procedure. The investigations will be conducted by the IA, but the data and relevant information should come from the customs office and in turn any determination of the IA should be imposed by the customs office. As such, absent adequate coordination with customs office, an investigation cannot be adequately conducted and a decision cannot be reasonably applied. Both of them are fertile sources of a wide range of trade disputes and various claims for WTO challenges.

Therefore, the GOA may consider including customs office and its officials in any future finalization of trade remedy measure legislations and enforcement decrees.

### 3.1.4. English Translation of Major Laws and Regulations

In addition, trade remedy-related legislations and regulations are required to be fully translated into English. This is necessary for the GOA to fulfill its obligation to notify the WTO of them in accordance with the relevant provisions of the WTO Agreements and to inform foreign exporters and governments of them in due course. To some extent, it is usually the English translation that ultimately counts because foreign companies and governments usually refer to English translation of the laws and regulations that the GOA submits or publishes when it comes to a particular dispute either in domestic or in international settings.

Thus, mis-translation or insufficient translations will cause unnecessary trade friction. Sometimes a provision in the original statute is actually proper, but its translation into English may not. Sometimes, it could be simply a clerical mistake, but sometimes it could invite unnecessary trade friction with other Members. Frequent problems arising from translation include failures to deliver the exact meaning, inadvertent error in using the right words, inconsistent use of words for the same terms or conveyance of different legal meaning than the original language.

To address these problems, the GOA may consider the following things. First, it may consider preparing a list of words and their proper English translation for continued reference by all the ministries and agencies in the future. This may help enhance the level of consistency in various legislations and regulations to be adopted by different government agencies at different points in time. At the same time, the GOA may also consider inserting subjects and avoiding passive forms as much as possible as, according to Korea’s experience, they usually create confusion when translated into English. In each translation of documents, the GOA officials should also adopt English terms that carry the exact meaning of the original terms in the Azerbaijani statutes. If a proper English term for the original Azerbaijani term does not

exist, the GOA officials may try to use footnotes or indexes to note these differences.

## 3.2. Creating IA

The IA is the government agency that is in charge of administering the laws and regulations of the trade remedy measures. In fact, the success of the trade remedy system of a WTO Member is very much dependant on the ability and effectiveness of the IA. It would not be an exaggeration to state that trade remedy measures start and end with the IA.

### 3.2.1. Importance of the IA

An IA is essential in the WTO regime because it provides the only legal mechanism to protect domestic markets from unfair trade. An effective and competent IA not only allows the GOA to regulate foreign imports as necessary but also operates as a counter-weight for trade remedy investigations by foreign IAs against Azerbaijani exporters. An active IA is also directly related to the GOA's successful engagement in various negotiations and discussions at the WTO on a continued basis, as shown by the examples of China and India. These two countries only recently expanded their IAs and vigorously conduct trade remedy investigations. As a result, they are increasingly becoming more active players in trade remedy negotiations in the WTO as well.

In the past, these countries used to be (and currently still remain as) one of the major targets of antidumping investigations by other countries. However, as they themselves possess active IAs, these countries have come to resort to the antidumping investigations more increasingly than any other country, which has then led to protecting domestic market effectively from allegedly unfair trade, increasing revenues from extra duties, and using them as a counter-measures against an illegitimate investigation by foreign IAs against the products exported from these countries.

So, it is necessary to enact laws and regulations to make sure that the IA operates efficiently inside the GOA in accordance with the WTO Agreements. Wrong or deficient legislations or regulations means not only the violation of the WTO obligations as such, but also losing an effective defense mechanism under the WTO regime.

In the draft law, however, one could hardly find mentioning of the IA (other than Article 60). Maybe in a different law, there exist provisions regarding the creation, operation and management of the IA. If that is not the case, the GOA should initiate this process as soon as possible. This should be the first step in formulating the trade remedy regime of Azerbaijan.

In fact, this is not simply a matter of choice, but an obligation for Azerbaijan. Under the WTO Agreements, Azerbaijan assumes the obligation to create an IA (if it desires to conduct trade remedy investigation while in compliance with the WTO Agreements) to conduct antidumping investigations, anti-subsidy investigations and safeguards investigations against products from other countries.[16] The IA is supposed to be placed under a ministry or as a stand-alone organization, composed of trade regulation experts who are independent, neutral and objective.

As the GOA does not have much experience of a "trade remedy" investigations before, creating this authority does not seem to be an easy task for the GOA. The GOA officials confirmed during the pilot study that Azerbaijan has handled only a few antidumping investigations. Many other countries have extensive experience in these investigations even before the WTO membership. They have regulations, precedents and work force already in place at the time of the WTO entry. The United States or the European Communities are good examples in this regard. Korea also introduced its own IA - the Korea Trade Commission - in 1987, well before the WTO accession. Nonetheless, operating an effective IA has been a daunting task for Korea. Since the GOA basically creates the organization from scratch, it would experience more confusion and logistical obstacle in this process.

Although Azerbaijan has not experienced a significant problem from the flood of foreign imports so far, it still needs to pay special attention to establishing a mechanism to deal with the surge of imports after the WTO accession. The WTO accession will lead to more market access and penetration by foreign imports into the Azerbaijani market. Sooner or later, there will be complaints from various Azerbaijani industries about the increases of foreign imports. China offers a good example in this regard. At present, as noted above, China has become the number one target of antidumping investigations world-wide: in an average of every seven antidumping cases world-wide, one involves Chinese products. At the same time, China has become one of the robust users of antidumping investigations itself against foreign products. For example, in 1995 to 2004, China initiated 72 antidumping investigations making the country the 10th most frequent users of antidumping investigations against foreign imports. The surge has occurred after the entry of the WTO in 2001. In any event, China has been the most frequent victim of antidumping investigations traditionally, but it has now become one of the most frequent users of antidumping investigations themselves, particularly after the WTO entry.

16. Although it may theoretically be possible for a Member to conduct a trade remedy investigation in accordance with the relevant provisions of the agreements without an IA, such an investigation is practically impossible. An IA should be established, either on an ad hoc basis or a permanent basis, for a Member to fulfill the obligation under the relevant agreements. For instance, without an IA (either ad hoc or permanent), even an application for investigation cannot (at least, properly) be filed.

The situation will not be that much different in Azerbaijan. As much as it cares about export markets, the GOA will have to care about its domestic market and protect the domestic market from "unfair" trade practices, probably mainly from the EC and other former Soviet republic states, given their geographical closeness. To protect the Azerbaijani markets from unfair foreign penetration from these prospective import surges, the GOA needs to initiate a process to create an "IA" as soon as possible. China, for example, adopted its domestic law regulating trade remedy investigations in 2001 but amended it significantly in 2004 to add new items to beef up its IA and investigative procedures.

### 3.2.2. Location of the IA

One of the practical issues that needs to be contemplated more carefully is to determine where to put the IA inside the GOA. The IA could be established within a particular ministry, or as an independent entity. There are pluses and minuses in each approach, but the GOA needs to make a determination on the location of the IA soon. Under the current circumstances, the best candidate for the location would be the Ministry of Economic Development. One or two divisions may be established inside the Ministry of Economic Development right after the WTO accession to operate as an IA. It may be expanded to be a more full-blown investigating agency as time passes by.

Given that the GOA does not have much experience in the trade remedy sector, putting the IA under a particular ministry (such as the Ministry of Economic Development) would make it easier for the GOA to establish and operate the organization in the initial stage of the entry, as this can be done relatively easily with a simple decision. Such a scheme, however, may invite criticism about the fairness and impartiality of a decision in a particular case. In the long run, establishing the IA as an independent entity may ensure neutrality of the IA, but in the initial stage, the GOA may have to focus more on the logistical concern, which could be more easily achieved by establishing an IA inside a particular ministry.

### 3.2.3. Structure of the IA

In addition, the specific structure of the IA should also be contemplated in advance. The GOA, for instance, will have to decide whether it will separate particular units and, if so, how to separate a dumping investigation unit, a subsidy investigation unit and an injury investigation unit. This will also require decisions on who will be in charge of dumping, subsidy, and injury issues inside the IA, respectively. Likewise, the GOA also needs to make a decision as to whether the decision making body will be separated from the investigative arm. A more ideal way would be to have a decision making body separately from the investigating agency, but for practical purposes it would make more sense not to separate them in the initial stage of the IA development.

Relevant expertise will be accumulated later, but the basic structure needs to be confirmed before the accession. It would take a much longer time to change the basic structure in the middle of the process. That is why it seems important that the GOA possesses a roadmap in approaching the IA issue so that it can envision the basic structure of the IA early on. Preferably, these structures might be laid out in enforcement decrees or ordinances. The GOA may refer to the structure of the KTC as a guideline for this procedure, as the KTC's structure is the reflection of lengthy experience of Korea as an IA of a developing state.

### 3.2.4. Coordination between IA and Other Agencies After Accession

After the accession, the GOA may designate one agency inside the GOA as a coordinator of all WTO-related work and issues. As it currently stands, it seems likely that the Ministry of Economic Development will take up this role. This agency will be responding to questions, comments and complaints from other countries once Azerbaijan joins the WTO.

Considering similar experience of other Members, the GOA may experience an "explosion" of issues and enormous workload in the first couple of years of the WTO accession. It is simply inevitable, and all other new Members have gone through the same process in the initial stage. This "initial stage chaos" is usually caused by lack of logistical support, lack of coordination among various domestic interest groups, increase of requests/inquiries from other WTO Members, increase of requests/inquiries from private companies of other WTO Members, increase of requests/inquiries from Azerbaijani businessmen and companies, and increase of requests/inquiries from the WTO. Under these circumstances, a central coordinating agency is crucial. Without a central coordinating agency clearly in charge, different foreign governments and companies may contact different GOA agencies for the same topic. As there is one GOA from the eyes of the WTO and other Member countries, all agencies must give same or consistent responses for the same or similar issues. Without a central, coordinating entity, different agencies may give different answers. Most preferably, the Ministry of Economic Development can take this leading role in the initial stage.

In fact, as long as the central coordinating agency is equipped with the tools to coordinate the WTO related issues, it would not matter much as to where to place it. However, under the current situation where the Ministry of Economic Development has been taking the leading role in the WTO entry negotiations, it would seem reasonable for the agency to continue to carry out the function even after the accession. The current division of labor inside the GOA indicates that the Ministry of Economic Development will continue to be in charge of international trade negotiations. Thus, the Ministry of Economic Development should ensure that coordination among government agencies in WTO-related issues is duly achieved.

As a next step, there should also be coordination between the newly created IA and the

central coordinating agency to be created. This is the case because the work of the IA is directly related to the WTO issues almost all the time. The central coordinating agency should be aware of the activities of the IA and vice versa. As such, the IA on the one hand and the central coordinating agency inside the GOA (for instance, the Ministry of Economic Development) on the other should maintain a close coordinating relationship with each other so as to make sure that all GOA entities are on the same page on a particular issue. Depending on how these two GOA agencies exercise their collective leadership, other GOA agencies may support and cooperate in the chaotic stage after the accession. At the same time, this close relationship and coordination should not be too extensive as to make outsiders suspect the independence and neutrality of the IA as a quasi-judicial agency.

If the IA is located inside the Ministry of Economic Development and the Ministry of Economic Development will be in charge of the central coordinating agency for all the WTO work, then this coordination and information sharing will be done relatively easily. This may be an efficient alternative in the initial stage of the WTO entry of Azerbaijan. The GOA may then take a bifurcated approach in the future, as needs arise.

### 3.2.5. Building Infrastructure of the IA

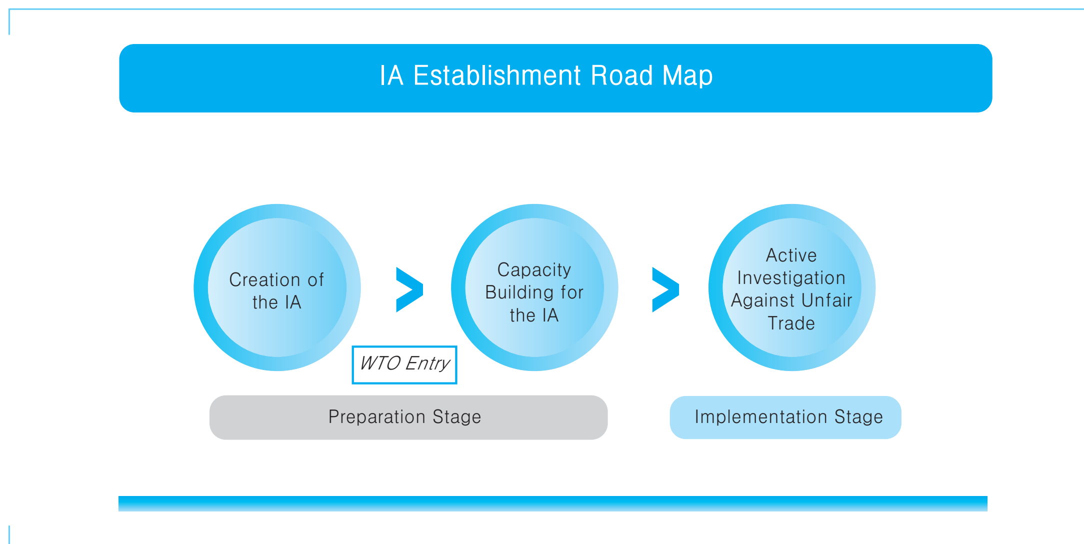
For the operation of the IA, financial and human resources are indispensable. Therefore, it is critical that the GOA initiates proper policies to build up the capacity and infrastructure of the IA. Without such a build-up, the laws and regulations would render meaningless because they are not to be implemented as they are written down. An investigation cannot be done within a deadline or through a specific methodology unless there is financial or personnel support.

In this respect, the GOA should introduce a system to retain and train investigation officials. It takes a long time to produce an expert who can conduct this highly complex investigation in a WTO consistent manner. It is quite telling that even the investigation officials in Japan have had a hard time in their first countervailing duty investigation conducted recently. Even if Japan has been a Member of the WTO for a long time and has been quite an active player in the field of trade remedy sector, it must have encountered practical difficulty when it conducted a countervailing duty investigation for the first time. The GOA, therefore, could consider selecting talented government officials and train them as future investigators of the IA. These officials should be dispatched to other countries sooner or later to be familiar with actual problems of the trade remedy investigations. Other WTO Members are usually eager to initiate an exchange program under which officials from both countries can visit each other's IA for a short period of time. This certainly would be a good opportunity for Azerbaijan's new IA. These investigators could also become WTO experts as well, as the expertise of the IA operation is the same expertise for the WTO Agreements and disputes.

In this context, the GOA may also consider dispatching the investigation officials to the Geneva mission on a regular basis. They could experience WTO dispute settlement procedure more directly and be prepared for the operation of the IA. The operation of the IA cannot be separated from the GOA's participation in the WTO meetings and conferences in Geneva. Furthermore, participation in WTO trade disputes as a third party would further provide opportunities to the IA officials to gain hands-on experience with the trade remedy measures in actual operation.

It is also recommended that the GOA introduce a system where the IA officials carefully study similar investigations done by the IAs of other countries. In this respect, the GOA may consider expanding the cooperative network with IAs from other countries. All of these may help the GOA build and expand the infrastructure of the IA.

To summarize the above discussion, the GOA may consider the following roadmap in the course of completing legislative work.




## 3.3. Aligning Investigations and Reviews

Most of the laws and regulations of the new Member usually omit adequate discussions on the review system once an investigation is concluded. In fact, the review procedure is the second part of the investigation. A comprehensive trade remedy measure, therefore, cannot be introduced unless a review mechanism is also considered and established. As such, the law should also deal with review systems of various kinds, including sunset reviews, periodic

reviews, changed circumstances reviews, etc. The specific names could vary, but the Members are supposed to have these systems in place once they are ready to initiate trade remedy investigations.

In the draft law, however, how the GOA plans to maintain these review systems does not appear. Refund of the duty has been extensively explained in the draft, but it is not clear whether this is done through a review or some other customs mechanism. At the same time, the draft uses the term "control review," but it is not clear what that procedure means, as this is the term that is hardly used in other Members. It is therefore advised that the GOA clarifies these issues. Obviously, it takes time and it may not be logistically feasible to contemplate the review systems at this juncture. If the GOA is under the time constraints, it does not have to provide for all the review procedures in detailed fashion, but it should nonetheless provide rules and procedures to the extent of the WTO Agreements.

## 3.4. Restructuring Judicial Review Mechanism

Under the WTO regime, Member countries are required to guarantee a reliable judicial review system once an administrative judgment is rendered (such as antidumping investigations or safeguard investigations, etc.) by the "IA." It is not entirely clear yet whether the current Azerbaijani judicial system will meet the standard of the WTO. It is apparent that most of the issues have been reconciled over the years, but there will probably be some areas where inconsistency still persists. So, probably the GOA will have to contemplate on measures to enhance the effectiveness, expertise and impartiality of the judicial bodies in Azerbaijan.

For example, in most of the developing states it is not entirely clear whether the judges in the courts are neutral and objective toward foreign companies and citizens from the perspective of an objective standard. In the same context, it is also not clear whether foreign companies and nationals have any restriction, statutory or *de facto*, in the access to the Azerbaijani courts and legal system. If there is any discrepancy in the treatment of foreign companies and nationals in the operation of the judicial system, that would become a potential target of a legal dispute in the WTO regime. China, for example, also has recently undertaken to reform its judicial system as a result of the WTO membership, but it is still subject to the complaints from other countries about its judicial system.

It appears that the GOA has a basic judicial system similar to that of other countries. But it should explore the necessity to adjust its judicial organization to be consistent with the WTO norm. More fundamentally, the GOA should align the trade remedy system with the judicial review mechanism. This can only be done by coordinating the trade remedy legislations with court organization legislations. As it currently stands, it does not seem entirely clear whether

such judicial review mechanism exists or is being contemplated in the course of the trade remedy legislation. This issue is raised not in the context of the judicial reform of some sorts, but in the context of the WTO trade remedy system.

## 3.5. Conducting Feasibility Test

The GOA is also advised to keep an eye on the practical aspect of the trade remedy investigation. For instance, as noted above, an effective trade remedy system is inseparable from the general customs system. The maintenance of the trade remedy measure only becomes possible through a reliable customs regime. Thus, to be feasible and practical, trade remedy legislation needs to be discussed with customs issues at the same time. Any trade remedy system cannot stand alone. Thus, the GOA will have to adopt measures to organize and strengthen its customs system as a prerequisite for the trade remedy system establishment. Most of the time, new Members only focus on the trade remedy system per se, only to realize that the system can only be maintained when coupled with a reliable customs system.

The GOA is also advised to explore the possibility of more active utilization of the safeguards measures. As is well known, a safeguard measure is a special exception allowed to a WTO Member, when the Member is suffering from a "surge" of imports for a particular product and the domestic industry of the Member state is on the verge of annihilation with "serious injury." While other trade remedy measures are aimed at "unfair trade," a safeguard measure is for "fair trade." In other words, it is an emergency action to deviate from otherwise applicable obligations as a WTO Member. The "serious injury" requirement, which is applicable in the safeguards investigations, is certainly a higher threshold than the ordinary "material injury" standard applicable in antidumping or countervailing duty investigations. A heightened threshold was adopted here, because it targets "fair trade," as opposed to "unfair trade," and because the foreign exporter has not done anything wrong.

Due to the unique nature of the safeguard measure as an emergency action, developing countries, newly participating in international trade have a tendency to prefer this measure to other trade remedies. By resorting to safeguard measures, the developing countries do not have to go through a myriad of legal requirements for antidumping or anti-subsidy measures. All they need to show is the "surge" of foreign imports and the "serious injury" its industry is suffering due to the surge. As such, it was relatively easy to implement the safeguard investigation. The GOA may take this aspect into consideration in devising the IA and the relevant procedures.

Korea was no exception. Traditionally, Korea also significantly resorted to safeguard measures in the early part of its operation of the KTC. As noted above, the KTC was established in 1987. Ever since, there have been 33 safeguards investigations initiated by the

KTC. Interestingly, out of the 33 cases, 29 cases were investigated before 1995 when the WTO regime set in, and only 4 safeguards investigations were conducted after 1995. In short, the bulk of the safeguard investigations were conducted in the early stage of the KTC operation, when the GOK was not fully equipped with expertise and knowledge in trade remedy measures.

The same may also apply to Azerbaijan. Needless to say, Azerbaijan will see a drastic surge of foreign imports in certain sectors after trade liberalization as a result of the WTO accession. Azerbaijani domestic producers may try to apply to the GOA for antidumping or anti-subsidy investigations, or other remedial actions, as the case may be, but sometimes it will not be easy to meet the requirements for those respective measures. In the meantime, the Azerbaijani industry may suffer substantial damage from the surge of foreign imports. If that is the case, the only legal avenue available for the GOA and the Azerbaijani industries would be a safeguard measure. Such being the case, the GOA is encouraged to initiate thinking about basic strategies for safeguard measures and adopting necessary domestic legislation and regulation for a safeguard action. In fact, this is another reason why it is important to establish an effective IA as soon as possible and staff it with competent officials.

At the same time, another practical question is how to prepare and publish official determinations. The WTO Agreements require IAs to prepare thorough determinations and publish them officially. Even if not specifically addressed in the law, this issue needs to be considered as well. After all, what is to be challenged ultimately by the foreign companies and governments is the determination of dumping or subsidy. In the current draft, it appears that a prior request from parties is required for the release of information, but the WTO Agreements require publication of the determination even without a request. This should also be adjusted in the final draft.

## 3.6. Active Participation in the WTO Dispute Settlement Procedure

Once Azerbaijan becomes a member of the WTO, there is no “grace period” for the country as a new Member. Azerbaijan will be required and expected to fulfill its obligation immediately, unless otherwise provided in the accession protocol. As a result, other Members will simply regard Azerbaijan just like any other existing Member, with the same level of expectation from Azerbaijan. These countries will not necessarily sympathize with Azerbaijan, taking into consideration the lack of experience and absence of necessary infrastructure in the initial stage of the WTO membership.

Furthermore, as the GOA is already aware, the WTO regime is highly technical and complex. The whole regime is a treaty-based one, operating based on legal arguments and legal

claims. This means that any communication and correspondence that the GOA will undertake after the WTO entry date in 2009 will carry certain legal importance and implication irrespective of the true intention of the policy makers or GOA officials. Most notably, in measuring any violation of the WTO Agreements, the intention of the government does not matter, but only the effect does. In other words, the GOA may be held liable even if it is trying to do something in good faith. That is why the GOA needs to be fully informed of the legal parameters of the all the WTO Agreements. More than anything else, all positions and arguments of Azerbaijan at the WTO need to be formulated and expressed in "legal" terms and accepted by other members as expressing Azerbaijan's "legal" position under the WTO Agreements. When there is a dispute at the WTO or at any other legal forum interpreting Azerbaijan's WTO rights and obligations, the GOA will have to defend its rights and force other Members to abide by their obligations through a "legal" procedure, that is, at the WTO dispute settlement procedure, or domestic courts of other Members, all of which are entirely legal frameworks.

Therefore, it appears to be a good strategy for the GOA to participate in the WTO dispute settlement procedure more actively so as to get familiarized with development at the WTO. As a Member, Azerbaijan can participate in a dispute between other Members as a third party Member. As a third party Member, the GOA can obtain legal submissions from the parties and attend the public hearing of the Panel and the Appellate Body. These documents and attendance provide crucial guidelines and insights as to how these issues could equally apply to the situation of the GOA. This would be good reference guidelines for the GOA in general and the IA in particular. Such being the case, it would be highly desirable if the IA officials could participate in these procedures with other GOA officials. They could then disseminate their experience once they come back to Baku.

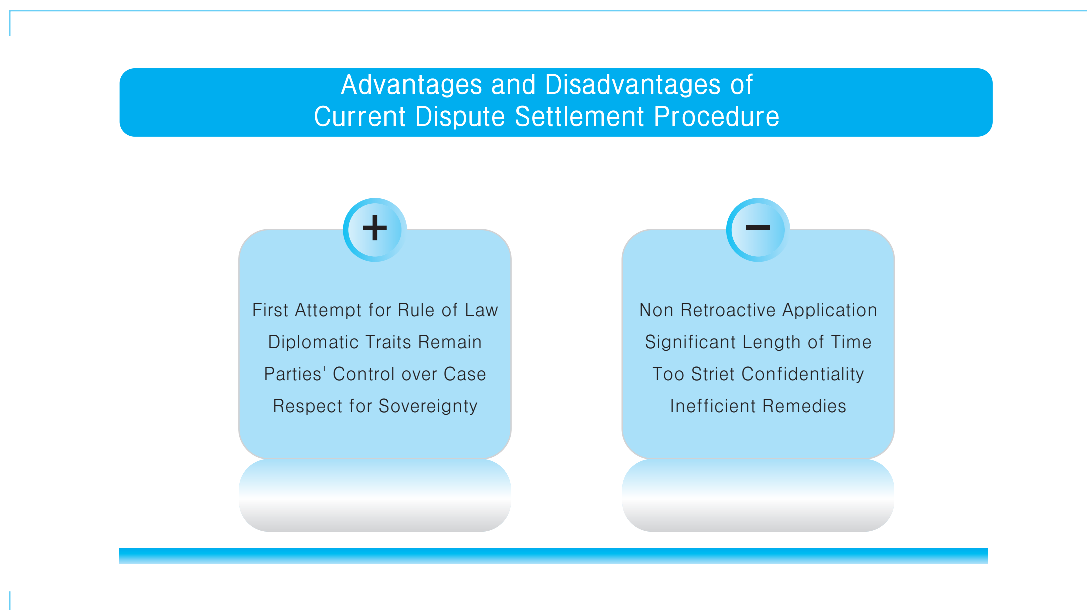
IA officials' participation in the WTO dispute settlement procedure is also necessary to avoid the situation where the GOA makes contradictory statements regarding a particular issue in two different stages. Once the GOA makes statement concerning a particular issue, it needs to maintain such a position in actual investigation of the IA. If there is a discrepancy, foreign companies and countries would accuse the GOA of having an arbitrary decision making process inside the IA. Therefore, the IA officials should participate in the dispute settlement procedure and be aware of the development of the positions of the GOA in the WTO dispute settlement procedure. By way of example, in a recent dispute, Indonesia claimed that Korea has maintained two different positions regarding the application of Article 6 of the Antidumping Agreement based on Korea's prior statement in other disputes and Korea's position in the dispute at hand against Indonesia. Although this allegation has turned out to be factually erroneous,[17] this shows that maintaining consistent statements and positions is important in the

17. United States-Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods From Argentina (WT/ DS 268), Recourse to Article 21.5 of the DSU by Argentina.

administration of the IA and participation in the WTO dispute settlement procedures.

Furthermore, being apprised of the WTO dispute settlement system may help the GOA take advantage of the loopholes of the current WTO regime in the actual trade remedy investigations of the trade remedy measures by the IA. Under the current WTO regime, for instance, a losing party could drag its feet in implementing the decision. It may take three to four years from the bilateral consultation to the finding of non-implementation by the losing party through a 21.5 dispute. This practically means that the GOA could be more aggressive in administering trade remedy investigations than it otherwise would be as it takes a long time before the GOA is legally forced to withdraw the measure as a result of the WTO dispute. In addition, the current WTO regime follows a strict non-retroactive application principle. This means that the losing party does not have to provide refund of antidumping duties or CVD duties to the foreign respondents or their governments even if it loses in a dispute at the WTO. Using this kind of tactic could certainly invite criticism from other Members, but the GOA should at least be aware of the possibility when it adopts an aggressive investigation by its IA.

It is certainly true that many people opine that the current dispute settlement system of the WTO is a significant stride from the previous GATT system. But there still exist various loopholes. The positive aspect and negative aspect of the current WTO dispute settlement system can be shown in the following diagram.



The GOA may take the current situation into account in operating its trade remedy investigations. Even if a measure of the GOA IA is challenged at the WTO dispute settlement system in the future, it may legitimately attempt to take advantage of the current loopholes, as with any other WTO Member, in a way that protects the interest of Azerbaijan. This provides another reason why the GOA needs to pay attention to the development of the WTO dispute settlement procedure for the purpose of operating the IA as well.

### 3.7. Review of Existing Measures

The IA of the GOA, once established, needs to review existing laws, regulations, and practices across the board to see if there is any inconsistent element in the existing trade remedy measures. In this process the IA also needs to review existing trade remedy measures being imposed, if any, against a product from Azerbaijan. Although obligations arising from the WTO Agreements only attach once a Member joins the WTO, the GOA should establish a database of the existing measures both by the GOA against foreign product and by the foreign government against Azerbaijani product.

## 4. Korea's Experience

This chapter discusses the experiences of Korea in establishing and operating the IA under the WTO regime. As Korea has established the IA almost from scratch and has developed it into one of the successful agencies of the government, the Korean experience may provide the GOA with some insights in addressing these issues.

### 4.1. Legislative Work

Korea has enacted various legislations and decrees after the accession of the WTO. Even recently, Korea still amends the existing legislations and enforcement decrees to make sure that they are in full compliance with the WTO Agreements. Six major legislations and enforcement decrees in the sector of the trade remedy measures are (i) Act on the Investigation of Unfair International Trade Practices and Remedy Against Injury to Industry (ii) its enforcement decree, (iii) Foreign Trade Act, (iv) its enforcement decree, (v) Customs Act, and (vi) its enforcement decree. They are all available in English from the website of the KTC for the GOA's reference.

Through these statutory frameworks, Korea has also accomplished that its internal

guidelines and practices are basically in compliance with the WTO Agreements. This has been made possible through various trial and errors for the past 21 years since the inception of the KTC in 1987. Korea is still in the process of checking its legislations, regulations and practices to make them more in line with the WTO Agreements. Recent disputes with other countries (such as the dispute with Indonesia) have provided further opportunities to fine-tune the KTC's investigatory procedure. This project will continue in the future.

## 4.2. Investigating Authority

The KTC has significantly expanded its organization and taken up more important roles for the Korean economy in the WTO era. The role of the KTC has been further expanding in recent days to cope with new environment caused by the spread of the FTAs.

### 4.2.1. Expanding Roles of the KTC

As time passed by, Korea has realized the importance of the role of the IA in the current multilateral trading regime. As an export-oriented country, traditionally Korea has been less concerned about imports than its exports. Then it has come to realize that the WTO regime and FTA regime all mean gradual increase of foreign imports, and that as such regulating import is increasingly critical. Having realized that the only legitimate import regulation under the WTO and the FTA regimes is through the trade remedy measures, Korea thus has continuously expanded the infrastructure of its IA. As a result, the KTC plays a more important role than before.

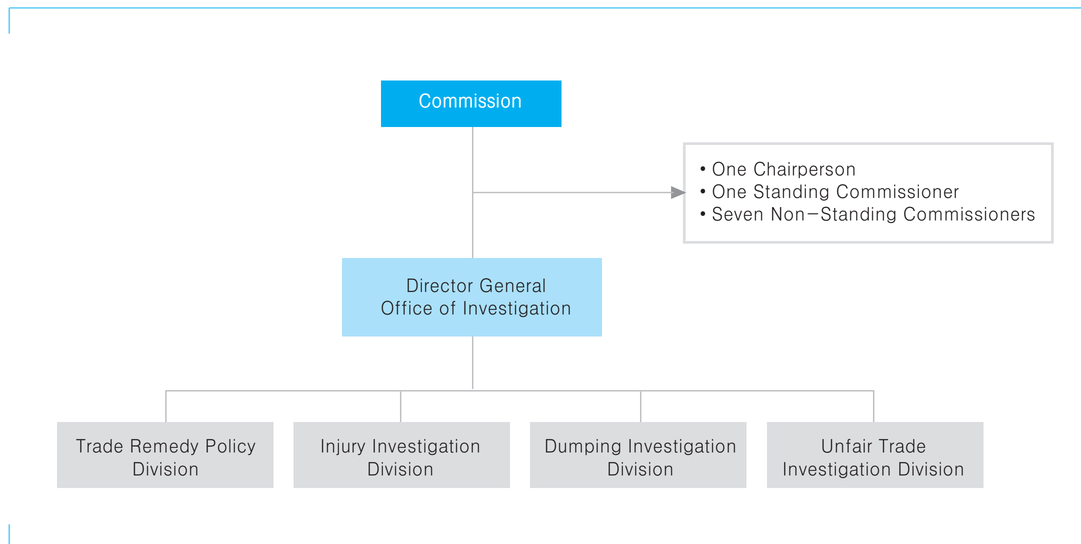
At the same time, it has also turned out that having an active IA means more effectively responding to illegitimate or dubious investigations by another country against Korean products as well. An active KTC has been operating as a counter-balance for the investigations abroad.

Under these circumstances, Korea will continue to increase its IA's logistical and personnel infrastructure in the future. In addition, as the number of investigations increases, Korea has also realized the importance of maintaining various due process requirements, such as providing equal opportunities to both parties at all times, responding to comments from interested parties, explaining fully all small decisions the IA makes, avoiding ex parte contacts. Through these final touches on procedural issues, which have taken place for over a long period of time, Korea has basically accomplished requirements of the WTO Agreements.

### 4.2.2. Structure of the KTC

The KTC is currently composed of one chairperson and eight commissioners, including one

designated as a standing commissioner. Commissioners are appointed by the President upon the recommendation of the Minister of Knowledge Economy (formerly, Ministry of Commerce, Industry and Energy). The Chairperson and Commissioners serve overlapping terms of three years each, and may be reappointed. The KTC is supported in its administrative work by the Office of Investigation, which consists of four Divisions: the Trade Remedy Policy Division, the Injury Investigation Division, the Dumping Investigation Division, and the Unfair Trade Investigation Division. The structure of these divisions can be illustrated as follows:




Each division is in charge of the following activities.

| Description | Responsibilities |
|---|---|
| Trade Remedy Policy Division | - Basic policy on the operation of Trade Remedy system<br>- Study and research of the laws and institutions<br>- Public relations on the Trade Remedy system<br>- Administrative works of the KTC - To receive petitions for industrial injury investigations |
| Injury Investigation Division | - To investigate whether to initiate an investigation of injury to domestic industry, on the receipt of an application for AD or CVD investigation<br>- To investigate whether the injury to domestic industry has been caused by the dumped or subsidized products |
| Dumping Investigation Division | - To investigate whether a certain product has been dumped or not, and how much the dumping margin was, if dumped<br>- To investigate whether the subsidies were paid or not, and how much the amount of a subsidy was, if paid |

| | |
|---|---|
| Unfair Trade Investigation Division | - To investigate whether the injury to domestic industry has been caused by increased imports<br>- To investigate Unfair International Trade Practices such as infringement on intellectual property rights, violation of rules of origin and other practices that threaten to disturb export and import accords<br>- To investigate the impact on the competitiveness of the domestic country |

These divisions have been established on the belief that all these issues require separate professional expertise. As shown in the above table, the Dumping Investigation Division is in charge of antidumping investigations and countervailing duty investigations. The statistics for the antidumping investigations can be found from the KTC website in English as well. On the other hand, Korea has not conducted a countervailing investigation yet, but it is expected that the KTC may deal with the first countervailing duty investigation sooner or later given the increasing disputes involving governmental subsidies.

The Injury Investigation Division is in charge of material injury investigations in the course of antidumping and countervailing duty investigations. Unfair Trade Investigation Division is in charge of safeguards investigations and IPR infringement violations. All these divisions have accumulated a significant amount of expertise in respective areas and have successfully retained a wide range of professionals (lawyers, accountants, entrepreneurs, academic scholars as well as government officials). Having a wide spectrum of professional expertise has indeed helped the KTC to deal with complex trade disputes arising from recent antidumping and countervailing duty investigations. Background in economics and accounting is increasingly in high demand in the KTC.

### 4.2.3. Accomplishments of the KTC

The KTC has accomplished various tasks. Given that Korea is an export-oriented economy, the GOK did not pay that much of attention to protecting domestic markets. Korea has been more interested in expanding Korean exports in foreign markets than protecting the Korean market from foreign imports. Recent surge of imports due to further liberalization under the WTO regime and FTAs has, however, taught the GOK the importance of the KTC as the Korea's IA. Indeed, the GOK and industries are increasingly concerned about imports.

As a result, the KTC is currently making efforts to expand its role and diversify its function since 2004. The KTC holds frequent workshops with Korean SME companies to help them understand the role of the KTC and disseminate information on how to file a petition and what to provide as underlying materials. The KTC also tries to disperse consensus among the Korean society and the Government of Korea ("GOK") on the necessity to protect the Korean market

from dumped and subsidized foreign imports. To keep up with the enhanced role of the KTC, the GOK is currently considering expanding staffs and workforce at the KTC. The GOK is also constantly reviewing whether it needs to change rules and regulations relating to the KTC to accelerate trade remedy investigations in Korea within the boundary of the WTO regime.

Over the years, the GOK realized that having a strong and effective IA in place serves two purposes; one is to protect the innocent Korean domestic producers from the unfair foreign import penetration, and the other is to suppress future trade cases by foreign governments against Korean producers. Particularly, the second element is based on the GOK's realization that more aggressive defense of the domestic market also tends to guarantee a fairer investigation by foreign IAs against Korean exporters in their own trade investigations. That is so, because the foreign government would have to look over their shoulders one more time, to make sure that their exporters are not retaliated in the Korean market by the GOK in one way or another.

As the KTC expands its function, trade disputes are also on the rise. Other trading partners closely monitor the KTC's antidumping and other trade investigations, and raise legal claims when they believe that the KTC's antidumping orders or other decisions are not consistent with WTO norms. They bring the case either to the WTO dispute settlement body or to the Korean court. For example, in 2005 Indonesia brought a WTO dispute against Korea regarding the KTC's antidumping order against papers from Indonesia. The Appellate Body rendered a split decision for the parties, for which Korea has implemented in accordance with the Appellate Body decision in 2007. Indonesia also brought a case against the KTC at the Korean court, who ruled also in favor of the GOK in 2006.

The recent prevalence of the KTC at the WTO and the domestic court strengthened the confidence for the KTC and other GOK agencies. As a result of these recent disputes, the GOK further acknowledges the importance of beefing up the KTC as the GOK's IA. In addition to strengthening its organizational structure, the KTC is fine-tuning and revamping its investigation practice and procedure in order to prevail in yet another possible dispute at the WTO in the future. In sum, Korea fully recognizes the importance of having an effective IA in the WTO regime.

### 4.2.4. KTC's Networking Initiative

The KTC has also significantly increased its network with foreign IAs. This effort has provided various practical benefits to the KTC. For example, this networking effort has provided opportunities to learn about the laws and procedures of the other trading members. This has also offered opportunities to establish affiliation on both personal and institutional levels among the IAs. Particularly, the exchanges with IAs of developed countries helped the

KTC enhance its investigatory capacity. In this respect, the on-going exchanges with the United States International Trade Commission and the Canadian International Trade Tribunal all turned out to provide relevant information and insights.

This kind of networking effort could be considered by the GOA as well. Exchanges with IAs from developed states and those with developing states would provide respective benefits to the IA of the GOA. The GOA may explore the possibility of enhancing exchanges between IAs among former Soviet bloc countries who may have similar background and go through similar difficulties in the early stage of the WTO accession.

### 4.2.5. KTC's Public Relations Initiative

For a long time, only a few Korean companies were aware of the role and function of the KTC. Thus, the Korean companies were not aware that they could initiate an investigation against unfair foreign imports. This was one of the reasons for less-than-optimal utilization of the KTC in the past. Starting from 2004, the KTC has increased its effort to disseminate relevant information so that Korean companies can resort to the system. This has turned out to be quite successful for the further penetration of the KTC to the business activity of the Korean companies.

The GOA might consider a similar policy to inform the public of the new system to be introduced as a result of the WTO accession. This project may dissipate some of the concerns harbored by the general public and industries who may fear the negative impact from the trade liberalization as a result of the WTO accession. The GOA may explore following items: holding seminars, publishing pamphlets, establishing a public fund to assist Azerbaijan companies in this regard, and increasing discussions and contacts between government officials and company officials.

Furthermore, in the early stage of the WTO entry, it would also be helpful if the GOA resorts to "self-initiated" investigations. This is the investigation which is conducted without prior request from the companies. As the companies are not normally aware of the full procedural and substantive requirements in the early stage, given the experience of Korea, the GOA may increasingly positively exercise its discretion for self-initiation. Needless to say, the option of self-initiation also requires capacity building on the part of the IA of the GOA.

## 4.3. Judicial Review

It is increasingly the case that foreign respondents and government bring a legal action against the Korean government in the Korean court, arguing that a particular antidumping or

countervailing measure is inconsistent with the WTO Agreements and the Korean law. This trend is causing the KTC to increasingly review and evaluate data more carefully in the course of the investigations.

As Korea incorporates the WTO Agreements as domestic law automatically, the reviewing court can also refer to the WTO Agreements as a source of the applicable law in addition to the Korean statutes. This is now creating another problem as to what the court should apply when there is a discrepancy between the WTO Agreements and the applicable Korean statutes and when the WTO (such as the Appellate Body) pronounces rules that the GOA does not necessarily agrees with. All these issues have not been raised in the past, but due to the increasing judicial review challenge by foreign respondents and government, the GOK and the courts will have to address these issues more directly now.

## 4.4. Participation in the WTO Dispute Settlement Procedure

Korea has been active participants in the WTO dispute settlement disputes, both as a party to a dispute and as a third party as well. Korea has participated in 25 disputes as a party and it is participating as a third party about in almost 40 disputes. This experience has helped the GOK and the KTC a lot in formulating and administering its investigation techniques and policies.

In the past, Korea was not an eager participant in the WTO dispute settlement system. The Agricultural Product Import Testing dispute with the United States in 1995, however, has caused Korea to more actively participate in the WTO dispute settlement procedure. At first, Korea did not want to initiate a trade dispute with its key ally and tried to avoid the dispute as much as possible, willing to yield to the U.S. demands in many respects. Unreasonable U.S. demands, however, forced Korea to pursue the dispute settlement procedure at the WTO. Once the dispute settlement procedure was initiated, Korea presented its legal argument aggressively. This aggressive tactic somewhat surprised the United States and made it consider settling the dispute through negotiation. As a result, Korea could achieve an acceptable compromise from the United States. The United States became more cautious in approaching trade disputes with Korea since the dispute and the experience taught the GOK an important lesson that active utilization of the dispute settlement procedure based on WTO Agreements would help Korea guard its trade interests. This may be equally applicable to Azerbaijan and the GOA. More active participation in the WTO dispute settlement procedure may help the GOA to establish and develop its IA in the long run.

## 4.5. Specific Issues in Antidumping Investigations

By nature, an antidumping investigation is fact-specific, company-specific and industry-specific. So, specific areas of interest and areas of concern might be different from industries to industries and from companies to companies. From foreign exporters' perspective, who are predicting or defending antidumping investigations in Korea, following issues usually attract attention in actual investigations. This may provide further guidance to the GOA in predicting areas of importance in an antidumping investigation.

### 4.5.1. Initiation

Under the WTO regime, initiation of an antidumping investigation is not supposed to be an automatic or a rubber-stamp process once a petition is filed by a domestic industry. Rather, it is designed to be a meaningful step where the IAs carefully look into substantive information contained in the petition and determine whether the petition is really worth the time and money to be inflicted from the lengthy investigation. Unless this filtering process operates effectively, foreign exporters would be in a severely dire situation regardless of the final outcome of an antidumping investigation.[18] In other words, the investigation itself would constitute a non-visible trade barrier. Thus, Article 5.2 of the Antidumping Agreement provides a detailed list of information to be included in an application (i.e., petition) for there to be a legitimate initiation by an IA. The Article provides that:

> An application under paragraph 1 shall include evidence of *(a)* dumping, *(b)* injury... and *(c)* a causal link between the dumped imports and the alleged injury. *Simple assertion, unsubstantiated by relevant evidence, cannot be considered sufficient to meet the requirements of this paragraph*. The application *shall contain such information as is reasonably available to the applicant* on the following:
>
> (i) the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant... ;

18. For example, due to the so-called "chilling effect" flowing from an AD investigation, a company defending an AD investigation "feels the direct hit" even in the initiation stage of the investigation, which is well before any preliminary or final AD determination. That is, importers of the foreign exporter named in the AD petition usually consider reducing or avoiding transactions with the foreign exporter due to the "uncertainty" in the market - the importers are not sure about the actual "price" of the product in the market to be determined in the future when there is an AD margin imposed. So, even if there is no actual duty imposition yet - whether preliminary or final - because of the initiation itself, the market already feels the effect of an AD investigation and the foreign exporter suddenly realizes that the export transaction has become more difficult than before. Therefore, initiation needs to be limited only to the good-faith allegations with sufficient information.

(ii) a complete description of the allegedly dumped product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;

(iii) information on prices at which the product in question is sold when destined for consumption in the domestic markets of the country or countries of origin or export and information on export prices;

(iv) information on the evolution of the volume of the allegedly dumped imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry. (emphasis added)

In addition, Article 5.4 of the Antidumping Agreement requires the IA to examine the sufficiency of "standing." The Article thus provides:

> An investigation shall not be initiated...unless the authorities have determined...that *the application has been made by or on behalf of the domestic industry...[with the support of] more than 50 per cent of the total production of the like product*...expressing either support for or opposition to the application,...[and the] *domestic producers expressly supporting* the *application account for...25 per cent [or more] of total production of the like product*. (emphasis added).

In addition, the IA is required to examine all the relevant information and the veracity of information before making a decision to initiate an antidumping investigation. When the required information is not provided, initiation should be duly rejected and any investigation should be terminated immediately. Article 5.3 and 5.8 of the Antidumping Agreement thus provide:

> The authorities shall examine the *accuracy and adequacy of the evidence* provided in the application to determine whether there is sufficient evidence to *justify the initiation* of an investigation

> An application...shall be rejected and an investigation shall be *terminated promptly* as soon as the authorities concerned are satisfied that *there is not sufficient evidence* of either dumping or of injury...(emphasis added).

Generally speaking, the Korean regulations concerning the initiation standard were designed to provide flexibility and discretion to the KTC. As opposed to explicitly requiring a thorough examination of all the relevant information, the current regulations requires the KTC to check and confirm whether initiation is basically warranted. This does not constitute violation of the relevant provisions of the Antidumping Agreement, as it is entirely possible that in actual individual investigations, the IA (i.e., the KTC) may consider and evaluate all the required

information, in which case Korea has entirely acted consistently with its obligation under the WTO, and Korea would prevail in any challenge at the WTO. It should be noted that Korea violates a WTO obligation only if it actually acts in a manner inconsistent with applicable rules of the WTO: in this case, for example, only if Korea does NOT terminate an antidumping investigation even if the provided information is not sufficient in a particular case (which would lead to an "as applied" challenge) or the Korean law mandates the KTC to initiate an antidumping investigation even with insufficient information (which would lead to an "as such" challenge).[19] Similarly, this principle is also applicable to all other issues discussed below.

Although this mechanism seems reasonable at this point, in the future Korea might consider changing the relevant provisions of the regulation that imposes the same standard as or higher standard than applicable WTO standards in order to ally the concerns of the foreign exporters and to ensure more uniform and consistent implementation of the WTO Agreements. Although that seems to be the more idealistic approach, stipulating these requirements on its surface would end up binding the hands of the IAs. The GOA may also consider similar approach in various issues of antidumping investigations.

In this regard, as long as provisions of the domestic legislations and regulations are termed as "permissive" using the term "may," the Member is usually protected from "as such" challenges by other Members. The GOA may also try to maintain discretion in various places by using the term "may" instead of "shall." For example, under the Korean regulations, even if information in the application is not sufficient, the IA has discretion (not obligation) to terminate the investigation, which is not exactly the same as provisions of Article 5 of the Antidumping Agreement, which stipulates "obligation" to terminate the investigation.[20] The KTC, however, administered this provision in a WTO-consistent manner. At the same time, the KTC could also maintain a considerable level of discretion in this regard. The GOA may also be able to maintain discretion but at the same time administer the investigation in a WTO-consistent manner by resorting to this kind of statutory formulation.[21]

19. The WTO jurisprudence in an "as such" challenge is what is called "mandatory/discretionary distinction," which means that as long as an authority or an official retains discretion under the statute or scheme, an "as such" challenge usually fails, even if the statute or scheme itself seems to be inconsistent with the WTO obligation. As such, for there to be an "as such" violation by Korea, the statute and regulation should force the IA to act in a way inconsistent with the WTO obligation. *See United States - Antidumping Act of 1916*, WT/DS/136/AB/R, WT/DS/162/AB/R (August 28, 2000), at para. 88-91.
20. See Articles 60 and 74 of Implementing Regulation of Tariff Act; Won-Mog Choi, *Analysis on Investigation and Regulation of Unfair Trade Practices in Korea, China and Japan: With Particular Focus on Antidumping and Countervailing Measures* (November 7, 2004) (hereinafter "Analysis on Antidumping Regulations") at 67.
21. *See Analysis on Antidumping Regulations, supra* note 14, at 67.

### 4.5.2. Domestic Industry

Antidumping Agreement requires domestic producers to occupy major proportion in the domestic industry producing like product in order for them to be regarded as domestic industry for the purpose of an antidumping investigation. Thus, Article 4.1 of the Antidumping Agreement states:

> Domestic industry shall be interpreted as domestic producers whose collective output constitutes *major proportion* of domestic production of those products" (emphasis added)

The Antidumping Agreement does not specify a specific number in determining "major proportion." Similarly, Korean Law/Regulation does not clarify what percentage satisfies the "major proportion" standard either.[22] However, it is noteworthy that some countries adopt the 50 percent mark as a threshold for "major proportion,"[23] and there is increasing consensus among countries in using 50 percent as the guideline in this respect.As such, Korea may consider adopting a similar provision, which adopts a 50 percent or more standard in determining whether a selected group of domestic producers does take up "major proportion" of domestic industry as required by the WTO.[24] As with other issues, a clearer and more predictable standard would certainly dispel concern and distrust of foreign exporters, defending an antidumping investigation in Korea. Having a clearer standard would also help the Korean government apply the Korean law/regulation in a more consistent manner, thereby increasing the likelihood of prevailing at a WTO challenge.

But, at the same time, the benefit flowing from preserving discretion as in the current provision should also be taken into account. By not stipulating a specific number, the KTC considers this issue from case to case. Thus, Korea is sort of maintaining its discretion in this area as well, and as long as it can show the existence of the major proportion, it satisfies the requirement of the WTO Agreements.

### 4.5.3. Public Hearing

The Antidumping Agreement requires that the IA provides adequate opportunities for public hearings in the course of an antidumping investigation. Article 6.2 of the Antidumping Agreement thus provides for obligation to hold meetings or hearings when there is a request

22. See Articles 51 and 57 of Tariff Act; Articles 59 and 73 of Implementing Regulation of Tariff Act; Articles 12 and 22 of Implementing Rules of Tariff Act.
23. For example, China and Japan adopt the 50 percent or more standard in this respect. *See Analysis on Antidumping Regulations, supra* note 14, at 55.
24. Id.

from the interested parties. The Article stipulates that:

> Throughout the anti-dumping investigation all interested parties *shall* have a full opportunity for the defence of their interests. To this end, the authorities *shall*, on request, provide opportunities for all interested parties to meet those parties with adverse interests, so that opposing views may be presented and rebuttal arguments offered (emphasis added)

According to Korean law/regulation, here also the IA has discretion, rather than obligation, of holding a public hearing.[25] In other words, under the Korean law/regulation, even if an interested party makes a request, the IA is still authorized to refuse to hold a public hearing. If the KTC indeed rejects a request for a public hearing in an actual investigation, that would constitute a violation of Article 6.2 of the Antidumping Agreement. As it appears that the KTC almost always holds a public hearing in an antidumping investigation whenever there is a request for one, this discrepancy would not make that much of difference in reality. As such, the KTC could maintain its discretion while stay within the parameters of the WTO Agreements. This might be considered by the GOA as well.

### 4.5.4. Application of "Facts Available" Standard

Facts available standard is a potent weapon for an IA in that the authority can legitimately adopt the information supplied by the petitioner or from any other source available. The measure, however, is not something that can be exercised at will by the IA. In the same context, the measure is not designed to inflict the severest penalty on the failing respondent. Given the highly adverse impact upon the failing respondent, the Antidumping Agreement provides for certain procedural requirements before the facts available standard is applied. Article 6.2 of the Antidumping Agreement thus provides:

> In cases in which any interested party refuses access to, or otherwise does not provide, necessary information within a *reasonable* period or *significantly* impedes the investigation, ...determinations...may be made on the basis of the facts available. The provisions of Annex II shall be observed in the application of this paragraph. (emphasis added).

Use of the term "may" rather than "shall" implies that the application of facts available should not be automatic even if there is non-cooperation from a foreign respondent; rather, the application of the facts available standard requires an examination of specific circumstances of a particular investigation to see whether application of the standard is indeed warranted. The term "reasonable" and "significantly" also connotes a case-specific inquiry by the IA into the

25. See Articles 64 and 78 of Implementing Regulation of Tariff Act; Article 12 of Regulation for Operation of Antidumping Duties and Countervailing Duties.

nature of alleged non-cooperation. Only "significant" impediment and refusal to cooperate within "reasonable" period of time allows the IA to resort to the facts available standard. In other words, an impediment or non-cooperation which is insignificant, or after-the-deadline submission of required information which is not too late does not allow the IA to wield the facts available standard. In this regard, Annex II of the Antidumping Agreement in turn provides for further safeguards by stipulating that:

> The authorities should also ensure that the party is *aware* that if information is not supplied within a *reasonable* time, the authorities will be free to make determinations on the basis of the facts available, including those contained in the application for the initiation of the investigation by the domestic industry.
>
> If evidence or information is not accepted, the supplying party should be informed forthwith of the reasons therefore, and should have *an opportunity to provide further explanations within a reasonable period*, due account being taken of the time-limits of the investigation.

Here again, the Antidumping Agreement obligates the IA to take preliminary steps before it imposes the facts available penalty. All in all, the Antidumping Agreement requires the IA to be cautious and reasonable in invoking the facts available standard.

Under the relevant Korean law/regulation, more lenient application of facts available seems possible.[26] For instance, there is not a specific provision stipulating obligation to inform the failing respondent of the possibility of applying the facts available standard nor a provision stating obligation to offer follow-up opportunities to foreign respondents to provide requested information later. If the application of the facts available standard is indeed implemented without offering such WTO procedural safeguards provided in Article 6.8 and Annex 2 of the Antidumping Agreement, a WTO panel would probably find Korea's application of facts available in a particular investigation inconsistent with the WTO. In addition, from the foreign exporters' standpoint, reasonable and predictable facts available application would be imperative. Regardless of this discrepancy, the KTC still administers the facts available standard in accordance with obligations set forth in the Antidumping Agreement. Korea will have to decide whether to maintain the current provision or explicitly add the same language of the agreement to the laws and regulations.

### 4.5.5. Sampling

Under Article 6.10 of the Antidumping Agreement, in calculating a dumping margin, an individual margin for each producer is the principle. On the other hand, an investigation by

26. See Article 64 of the Implementing Regulation of Tariff Act.

sampling is an exception, which is allowed only when the number of foreign exporters and producers is so large as to make individual margin calculation impracticable. Furthermore, the IA is obligated to consult with interested parties in selecting the samples in a particular case. Article 6.10 thus provides that:

> The authorities shall, *as a rule,* determine an individual margin of dumping for each known exporter or producer concerned of the product under investigation. In cases where the number of exporters, producers, importers or types of products involved is so large as to make such a determination impracticable, the authorities may limit their examination either to a reasonable number of interested parties or products by using samples which are statistically valid on the basis of information available...
>
> [The sampling]...shall preferably be chosen *in consultation with* and with the consent of the exporters, producers or importers concerned (emphasis added).

Although it is true that in many instances sampling is utilized as it is the only way of conducting antidumping investigations under the constraints of time and resources, the current Antidumping Agreement unequivocally states that individual dumping margin calculation is what an IA is supposed to do in principle.

Unlike this approach, the Korean law/regulation provides that sampling is a rule, rather than an exception.[27] Korean law/regulation provides that sampling method is the principle.[28] The Korean law/regulation also does not provide for a consultation requirement with the interested parties.[29] If the law/regulation is indeed applied in a way that sampling is a principle and consultation with interested parties is precluded, it may be found inconsistent with Article 6.2 of the Antidumping Agreement. But the KTC has also operated this requirement in a manner consistent with the WTO obligations.

### 4.5.6. Judicial Review

Article 13 of the Antidumping Agreement provides for the requirement that each WTO member offer an independent and meaningful administrative and judicial review process with respect to final antidumping measures. The provision thus states that:

> Each Member...shall maintain *judicial*...or *administrative* tribunals or procedures for the purpose...of the prompt review of administrative actions relating to final determinations...

27. See Articles 12 and 23 of Implementing Rule of Tariff Act.
28. Id.
29. Id.

Such tribunals or procedures shall be *independent* of the authorities responsible for the determination... (emphasis added).

In this regard, relevant Korean law/regulation does provide for an administrative appeal and judicial review for a final antidumping determination.[30] In reality, however, such appeal mechanism seems to be rarely used.[31] There may be various reasons for such non-use of the administrative or judicial review: one of the reasons may be the aggrieved foreign exporters' perception, whether correctly or incorrectly, that an appeal is not effective or recommendable in the context of the Korean antidumping investigations. Needless to say, the IA does not and cannot force such an exporter to initiate an appeal, but there may be some room for improvement by the IA to facilitate utilization of the appeal process. One of such areas of improvement may be to further guarantee independence of decision makers in the administrative appeal process as one could argue that Article 13 of the Antidumping Agreement requires both de facto and de jure independence of decision makers in administrative appeal process. With respect to judicial review, it would also be necessary to facilitate the utilization of the review process by an aggrieved party. In this respect, in the long run Korea might consider establishing a special court that is specifically charged with handling customs and trade issues given the required expertise in dealing with these issues.[32]

A more standardized and objective administrative appeal process and judicial review process would provide an effective mechanism through which not only foreign exporters but also Korean petitioners, who believe that the underlying antidumping determination is not what it should be, to correct or modify the antidumping determination. This will further enhance the notion of rule of law and protect integrity of any antidumping determination rendered by Korea. A well-organized appeal and review process will also shield Korea from WTO challenges. This is another area that requires further review and contemplation by the GOK in the near future. Korea's experience in this regard may be evaluated by the GOA in the future.

### 4.5.7. Confidentiality Issue

Under the current antidumping investigation system in Korea, attorneys and other representatives representing foreign exporters (i.e., respondents) in the investigation procedure

30. *See* Articles 119 and 120 of the Tariff Act.
31. See *generally* Korean Trade Commission, *Statistical Compilation of the Trade Remedy Measures* (January 2005).
32. For example, in the United States there is a special federal court, called United States Court of International Trade, to deal with customs and trade issues in particular. The judges and court clerks are trade and customs issues experts. In terms of the difference in the workload and issues presented, the current situation in Korea is not comparable to that of the United States, but from the longer term perspective Korea might have to move in the same direction.

do not have access to confidential data. In the same context, a detailed dumping calculation methodology and underlying data are not always made public either. To some extent, this is understandable because all information and data submitted in an antidumping investigation, either by a respondent or a petitioner, are highly confidential, which usually contain a wide range of price information and client information. If this information is made public or leaked to other competitors, the party would be seriously hurt in their market competitiveness position.

However, from a purely legal perspective, sometimes such complete containment of information puts foreign respondents in a difficult position to fully understand the rationale and logic of the final antidumping determination. The Korean petitioner would also suffer from such "blackout" of information, but the adverse effect would be more significant for a foreign respondent who is in a "defensive" position and physically more "detached" from the IA. Under the current law/regulation, opposing parties only receive access to public summaries of submissions that have been granted confidential treatment. It goes without saying that this restriction of information may significantly limit one's ability (particularly the foreign respondent) to prepare meaningful rebuttal comments during the antidumping investigation. Furthermore, this lack of access to underlying data may also be related with low occurrences of administrative appeal or judicial review in one way or another. If the number of antidumping investigations increase in the future, it seems obvious that complaints from foreign exporters will also increase if they (or their agents and representatives) do not have access to confidential information. More and more foreign respondents would request to see the underlying information and data. Not only the increase of the number of cases but also the increasing complexity would also prompt foreign respondents to have a look at underlying information and data.

As such, Korea has now finally reached the point where we will have to evaluate the feasibility of adopting a more "reasonable and flexible" mechanism to protect confidential information in an antidumping investigation, under which a limited group of authorized agents could be allowed to have access to confidential information. For example, in the United States, there is an Administrative Protective Order ("APO") system, where only designated attorneys and representatives (not company officials) are allowed to get access to underlying data and documents. The attorneys and representatives representing a foreign exporter are required to submit certification that they would not communicate with the client (i.e, foreign exporter who hired them) about the confidential data, and they are subject to a severe penalty once such certification is violated. From time to time, there may be violations here and there, but on balance such a system may increase the perception of fairness on the part of the foreign exporters. So, Korea may consider such a system in the future depending on the development of the surrounding situations.

The situation in Korea may provide guidance for the GOA in handling business confidential

information in the course of antidumping investigations. Korea also does not have a clear answer to this question, but the GOA may elicit some guidance on this issue.

### 4.5.8. Overall Procedural Fairness

All in all, from the longer-term perspective it is crucial to guarantee procedural fairness and transparency in antidumping investigations for a stable and reliable operation of antidumping trade remedy system. Needless to say, sometimes procedural fairness and transparency are more important than substantive rules. By nature, procedural rules are more subject to the discretion of IA than substantive rules which are more extensively regulated by Antidumping Agreement provisions, and as a result foreign respondents have inherently more concerns in procedural elements. In this regard, the KTC may consider adopting and publishing an "AD Investigation Manual" or "Policy Bulletin," which contains basic procedural guidelines as well as policy objectives and principles in AD investigations in Korea.[33] By making the guidelines publicly available, more practitioners and foreign companies could refer to the manual for procedural information. Such a manual, or its equivalent, would help standardize the procedures of the investigations and dispel any distrust on the part of companies from other trading partners. As sufficient knowledge and practice have been accumulated, the KTC may be able to prepare a manual in this regard. The Korean experience also sheds light on the future course of action of the GOA in operating its own IA.

## 5. Other Potentially Critical Issues

The final terms for Azerbaijan's entry are dependent on the results of the bilateral negotiations with trading partners. Once bilateral negotiations are done, "terms of accession" will be finalized by the WTO reflecting the outcome of the bilateral negotiations, which will then be submitted to the General Council or the Ministerial Conference of the WTO for a final approval in the form of an "Accession Protocol." The Accession Protocol of the WTO is a special agreement concluded between the WTO (and its members) and the country that is applying to join. An Accession Protocol contains lists of concessions that the applicants made as a result of negotiations with other WTO Members. When it is submitted to the General Council or the Ministerial Conference, basically negotiations will no longer exist and only "yes

33. In the case of the United States, AD Investigation Manual and Policy Bulletins provide detailed guidelines for foreign exporters facing AD investigations in the United States. See AD Investigation Manual and Policy Bulletins, retrieved from the website of the Department of Commerce found at http://ia.ita.doc.GOA.

or no" votes takes place.

As such, although there are basic rights and obligations stipulated in various provisions of the WTO Agreements, the bilateral negotiations and resulting Accession Protocol will basically dictate the "specific" terms for Azerbaijan. One can only determine the contours of Azerbaijan's rights and obligations by looking at these "specific" conditions and terms. This is why these bilateral negotiations are so crucial. For example, Transitional Product Specific Safeguard Mechanism ("TPSSM") is a 'special type' of a safeguard measure that is provided in China's Accession Protocol in 2001, which does not exist in the WTO Agreements. In short, the Accession Protocol for Azerbaijan will be a special law (*lex specialis*) applicable to Azerbaijan only as opposed to general rules stipulated in the WTO Agreements applicable to all member countries.

## 5.1. Non-Market Economy

When China and Vietnam joined the WTO in 2001 and 2006, respectively, the United States and other countries made significant effort to designate them as NME countries in order to impose antidumping duties more easily than against imports from other countries - such as imports from Korea or Japan. NME designation lowers a threshold in an antidumping investigation. In the context of antidumping cases, the NME status is disadvantageous for respondent exporters (i.e., Chinese or Vietnamese exporters) because the so-called NME "surrogate country" methodology can be subjective, unpredictable, and arguably unfair. The "surrogate country" methodology means that the IA (i.e., the United States) does not use the actual data from the company being investigated, but uses instead companies from another countries (for example, Bangladesh) that provide a rough approximation of the costs and prices in the home market (i.e., China or Vietnam). Due to the inaccuracy and wide discretion in choosing numbers, this methodology often leads to inflated dumping margins. As a result, in the same investigation, Chinese or Vietnamese companies are likely to get higher dumping margins than Korean companies or Japanese companies.[34]

34. The problem of the NME investigation was further proved by a recent high-profile antidumping case against Vietnam. In 2003, the American catfish industry, seeing rapid growth in market share of Vietnamese products, successfully lobbied for the imposition of duties — a decision, which infuriated Hanoi. As a result of tariffs of up to 64%, catfish exports to the US dropped by over 50%. Around the same time, a bilateral agreement imposed textile quotas, intended to dampen booming export growth.
In 2004, the USDOC imposed preliminary anti-dumping duties on Vietnamese shrimp, ranging from 12.11% to 93.13%. In this case, the U.S. producers also demanded higher tariffs on shrimp from Brazil, Ecuador, India and Thailand, which, together with China and Vietnam account for 75% of all U.S. shrimp imports. *However, the Chinese and Vietnamese cases were handled separately, because they are regarded as non-market economies*, a classification which gives the U.S. more leeway in establishing domestic production costs in dumping cases. The Vietnam Association of Seafood Exporters and

The same situation will also take place for Azerbaijan as well. These countries have been quite slow in adjusting the NME status to market economy status. For example, the United States only recently removed the "nonmarket economy status" that was applied in antidumping duty cases against Russian imports.[35] The negative impact flowing from the NME designation is even recognized by the U.S. government.[36]

This shows a potentially serious problem for future Azerbaijani exports. Being subject to an easier antidumping investigation rule coupled with explosion of the number of antidumping investigations will put Azerbaijan in trouble in the future, depriving the country of the significant portion of the benefits flowing from the WTO membership. Even if Azerbaijan is somehow given the ME designation at the time of the WTO entry, it will be busy defending antidumping investigations all over the world. But with the NME baggage, the burden will be doubled or tripled in the future. The NME designation will haunt Azerbaijan in the post-WTO era for a long time. In short, the NME issue is a problem for Azerbaijan now, even before the WTO membership, but the problem will loom larger once Azerbaijan joins the WTO.

### 5.1.1. NME Revocation Proceedings in the United States

As the United States offers the biggest export market for most of the countries and its designation heralds the position of other countries, it would be meaningful to look into the situation in the United States in this respect. In the United States, currently, six countries (Poland, Czech Republic, Hungary, Latvia, Slovakia, and Kazakhstan) have been successful in obtaining NME revocations and graduating to market-economy status. Requests for NME revocation are submitted once an antidumping investigation has been initiated. A separate process for determining NME status involves a public comment period, hearings, and post-hearing rebuttals.

The USDOC's decision-making process is not as transparent or as clear as one would like. Kazakhstan was granted full market status in March 2002 (involving silicomanganese); however, its steel industry was denied a ME determination in September 2001. Although the legal analysis is slightly different, it still seems inconsistent to deny an industry market status, while granting the entire country market status a few months later.[37]

Producers condemned it as violating the spirit of free trade and costing the jobs to millions of Vietnamese employed in the industry. Seafood products rank as Vietnam's fourth-biggest export and the U.S. is its largest shrimp market, taking nearly 50% of its shrimp exports. *See* Asia Pacific Bulletin, *WTO Entry Could Lower Trade Hurdles Facing Fast-Growing Vietnam* (July 15, 2004) (emphasis added).

35. William H. Cooper, Russia's Accession to the WTO, CRS Report for Congress (Apr. 20, 2006), at 20

36. Id.

37. *DOC found that Kazakhstan began operating as a full market economy on October 1, 2001.*

### 5.1.2. Operation Mechanism for the NME status

In the context of antidumping cases, an NME status is disadvantageous for respondent exporters because NME "surrogate country" methodology can be subjective, unpredictable, and arguably unfair. In theory, an NME stands a chance at getting lower margins if the surrogate country proves to have favorable data. However, the contention is, in practice, the methodology at best provides a rough approximation of the costs and prices in the home market, and often leads to inflated dumping margins.

During the investigation process, NME countries and affected businesses can submit recommendations for surrogate countries, but the USDOC, choosing from a list also provided by the petitioner, may not use the NME's choice country. The USDOC looks at the stage of economic development comparable to the NME, the extent to which the country produces comparable merchandise, and the comparable per capita GNP.[38] In a 2001 Belorussian case involving steel concrete reinforcing bars, the respondent Byelorussian Steel Works argued that South Africa was the appropriate surrogate country. South Africa's GNP ($3,160) was comparable with Belarus's ($2,630), and the countries shared the same increasing trend in GNP according to World Bank data. However, the USDOC chose Thailand as the surrogate country, reasoning that Thai's GNP ($1,960), its significant production of like steel products, and comparable economic development warranted strong consideration. The USDOC also considered the South African information to be unreliable and therefore, used Thailand as the surrogate country. Belarus's AD margin was finally determined to be 114.53%.

### 5.1.3. The Case of Kazakhstan

The USDOC's analysis of Kazakhstan may elucidate a trend in the USDOC decision-making and have some future significance to countries with requests for NME revocation.[39] First, using the Section 771(18)(b) factors for determining whether a country has met the standard of a market economy, the USDOC looks at the "totality of the facts," and does not take an approach comparing the subject economy with a perfect laissez faire economy. The USDOC's approach is, therefore, fairly subjective and flexible. The USDOC also emphasized the purpose of NME methodology— to remedy a faulty price formation process due to the absence of the demand and supply elements that make a market-based price system workable

38. On September 10, 2001, the USDOC changed its use of GDP for national income and wage rates to GNP.
39. The caveat here is perhaps the Kazakhstan decision was heavily influenced by Kazakhstan's powerful supporters in its NME revocation proceedings—Chevron Texas Corporation, DHL International, Exxon Mobil Corporation, the International Tax and Investment Center, AES Corporation, Motorola, the American Chamber of Commerce in Kazakhstan, the US Embassy, and the law firm of LeBoeuf, Lamb, Greene & MacRae.

and reliable, not a per se distortion of prices since, as the USDOC recognizes, even market economy prices are influenced by taxes, subsidies, and other regulatory measures. This again shows the USDOC's flexibility and perhaps a proclivity to a de jure analysis of NME status.

In July 2001, the government of Kazakhstan and Transnational Company Kazchrome requested NME revocation in response to an antidumping investigation on silicomanganese.The petitioners in the case are Eramet Marietta Inc., the Paper Allied-Industrial, Chemical and Energy Workers International Union, represented by Verner, Liipert Bernard Mcpherson and Hand. Comments in support of the petitioners and against revocation came from Bethlehem Steel Corporation, LTV Steel Company, Inc., National Steel Corp, and the United States Steel LLC.

On March 25, 2002, the USDOC granted Kazakhstan market economy status. The USDOC based its decision on the facts that Kazakhstan's currency is fully convertible, wage reforms are well-advanced, foreign investment, especially in the oil, gas and energy sectors, is well underway, and most sectors of the economy have been privatized. The USDOC also recognized some problems in the system, like slowed efforts to privatize its remaining government-owned enterprises, continued problems with wage arrears, corruption issues, but concluded that the overall changes Kazakhstan has demonstrated its complete transition to market economy. It may be of some significance that the respondents garnered support from Chevron Texas Corporation, DHL International, Exxon Mobil Corporation, the International Tax and Investment Center, AES Corporation, Motorola, the American Chamber of Commerce in Kazakhstan, the US Embassy, and the law firm of LeBoeuf, Lamb, Greene & MacRae, all of whom submitted comments in support of Kazakhstan's graduation to market economy status. The situation of Kazakhstan, as one of the former Soviet republics, provides a good example of what lies ahead when Azerbaijan expands its export to the major markets such as the United States.

## 5.2. Privatization

There is no clear guideline as to how much of the government involvement is permitted under the current WTO regime. As such, the GOA also does not have clear information as to the adequate level of government intervention in the business operation of key companies and industries. What is certain, however, is that the moment a government owns a company, a subsidy allegation in accordance with the SCM Agreement instantly arises.

Therefore, probably the GOA should immediately adopt a plan to privatize major state-owned enterprises. This may not be easy and will take a long time. The privatization will also carry significant social impact. Nonetheless, this is what is ultimately required under the WTO regime.

Korea has also extensive experienced in how to manage the relationship between the GOK and private sector in terms of the trade context. This issue is directly related to the subsidy issue which is regulated by the SCM Agreement, which prohibits all WTO member countries from providing illegal subsidies to their domestic industries or companies. As of now, Korea is increasingly concerned about illegal subsidy allegations by other countries. As is well known, during the period of economic development since early 1960s, the GOK has been involved with key Korean industries and companies in many respects, as with any other country in a similar situation. This "direct involvement" or "close relationship," however, is not the case any more, although there are still some areas that require further adjustment or separation. Korea has overhauled its economic system and financial structure since 1990s, more particularly as a result of its entry into the Organization for Economic Cooperation and Development in 1995 and through its efforts to overcome the financial crisis in 1997.

Despite this significant change, however, the foreign perception has not changed. Many countries still view Korea as a country subsidizing "favored" industries including steel industry, semiconductor industry, automobile industry, etc. This remaining perception is still leading to subsidy investigations against Korean exporters. For example, since 2002 Korea has been the target of subsidy investigations by the United States, the European Communities, and Japan regarding Korea's semiconductor industry and shipbuilding industry. The resulting hefty countervailing duties have created a significant barrier to Korean exports.

The subsidy investigations and extra duty (called a countervailing duty) have led to bilateral trade disputes and WTO disputes between Korea and other countries involving the SCM Agreement. After experiencing a continued surge of subsidy allegations and trade disputes, the GOK is now making efforts to expedite the process of distancing the government apparatus from private industries as much as possible. For example, the GOK has abolished almost all direct or indirect subsidy programs and plans for Korean industries.

Despite the efforts of the GOK, however, Korean exporters are still exposed to subsidy allegations by other countries. First of all, the lingering perceptions from the past is still haunting the GOK and Korean exporters. Secondly, since the "dividing line" between illegal subsidy and appropriate government function is sometimes blurry, other countries sometimes portray even the GOK's legitimate regulatory policy as illegal, disguised subsidization. Such being the case, currently the subsidy issue is by far the most significant headache for the GOK and will be so for the time being.

Dealing with the new threats from subsidy investigations, the GOK has learned an important lesson. First, the GOK has realized that subsidy disputes are completely different from antidumping disputes in that the former are directly targeted at the government and investigate governmental polices and programs. Therefore, the GOK learned that in order to avoid a

subsidy allegation and to prevail in a subsidy dispute, long-term effort of the entire government is crucial.

Secondly, the GOK has also learned that subsidy disputes carry much more far-reaching damage to Korea's trade interests than antidumping disputes, because they target the GOK's policies and programs themselves, which may involve a wide range of industries and companies that are covered by such policies and programs. On the other hand, antidumping investigations are simply aimed at individual companies and individual industries and consequently.

Upon entry into the WTO, the GOA needs to contemplate a long-term strategy to "dilute" the relationship between the GOA and Azerbaijani industries, step by step. Given the Chinese and Vietnamese examples, it seems to be simply a matter of time for Azerbaijan will have to face this subsidy issue. To avoid unnecessary confusion at that time, it is appropriate to consider future course of action early on. Furthermore, as the GOA is well aware, detaching the government function from the private sector or reducing the government role in the private sector takes a long time. This should also remain as one of the high priority tasks for the GOA in the WTO era.

## 5.3. Keeping Pace with Other CIS Countries

When Ukraine joined the WTO in April 2008, it became the third CIS country that joined the WTO after Kyrgyzstan and Tajikistan. Sooner or later, other CIS countries will join the WTO with short intervals. This would mean that Azerbaijan will be compared to other CIS countries in the initial stage of the membership as conditions and environment of these countries are basically quite similar. Thus, it is highly recommended that the GOA continues to monitor the development in other CIS countries with respect to the trade remedy legislation and management and make paralleled effort to keep pace with development in these countries.

This would serve two purposes. First of all, as long as the GOA keeps pace with other CIS countries, it could effectively respond to any possible complaint or claim from other Members in the area of trade remedy sector. As noted above, it is impossible for the GOA to accomplish all the requirements in the short time frame after the accession. Inevitably, it takes time. During this interim period, the GOA may be vulnerable in a prospective legal claim from other Members, since it may be in violation of a particular provision in an agreement. If it can show that it still keeps up with other similarly situated countries, it can effectively argue that more time is necessary to accomplish all the legislative work.

Second, by monitoring the situations in other CIS countries, it could elicit valuable lessons

from the experience in these countries' trial and error. Although with varying degrees, CIS countries will face similar problems here and there.

## 5.4. Eliminating the Appearance of Bias

It is critical that in any investigation, the GOA tries to avoid the appearance of bias for the domestic industry as much as possible. The GOA may try to reach a decision which may be favorable to the Azerbaijani domestic industry, but such a decision should be based on the arguable impartiality. To the extent the GOA maintains this position, it may attempt to exercise its discretion in a manner favorable to its domestic industries.

The GOA's maintenance of basic neutrality would help it to successfully defend a WTO violation claim from other Members; it may be able to argue that the violation simply occurred because of lack of experience on the part of the GOA although an investigation was conducted in good faith. To make this line of argument, it should be careful not to show an obvious discriminatory intent against foreign products.

## 5.5. Zeroing

During the interim and final workshops, there were questions from the Azerbaijani officials about the zeroing practice. Although zeroing may not affect the interest of Azerbaijan in the near future, this kind of inquiry is quite encouraging because zeroing seems to be the most controversial issue in the area of trade remedy these days. To be in full competition with other Members' IAs, the GOA's IA should also follow the development of key legal issues in the trade remedy sector.

In a series of recent disputes, the WTO Dispute Settlement Body determined that zeroing constitutes violations of various provisions of the WTO Agreements, but the United States continues to preserve the methodology. The GOA is advised to be appraised of the development of this critical issue to defend itself from possible application of zeroing against Azerbaijani products in the future, to actively participate in the multilateral discussions on this issue in various trade fora, and to make sure that it itself does not engage in similar calculation methodologies in an antidumping investigation.

## 5.6. Using the IAs to Defend Azerbaijani Companies from Dubious Investigations

At the same time, the IA of the GOA, once established, could operate as a taskforce to deal with trade remedy investigations from other Members. It could monitor trade remedy investigations against Azerbaijani exports and take necessary steps when there is a dubious investigation. Korea's experience shows that a government's strong desire to protect its exporters from harassment trade remedy actions from other Members indeed helps to reduce trade remedy investigations to reach an early resolution of the dispute even if there is one, because the investigating countries are usually also concerned about diplomatic friction with other Members.

In Korea's case, there is a Bilateral Trade Remedy Taskforce in the Ministry of Foreign Affairs and Trade which is led by a Deputy Director General. This taskforce is in charge of monitoring trade remedy actions against Korean exporters worldwide, identifying legal problems in these investigations, and meeting with officials from the investigating countries to discuss and negotiate. This has turned out quite successful in reducing the number of trade remedy actions by exerting diplomatic and political pressure. Most of the time, one of the most effective argument in these negotiations is usually the legal one based on provisions of the WTO Agreements. The taskforce actively analyzes legal issues of a dubious investigation and raises them during the bilateral negotiations. When necessary, it also notes that Korea will bring up legal actions at the WTO Dispute Settlement Body if the counterpart goes ahead with the investigation in that manner. So, the IA of the GOA could operate as a taskforce where trade remedy specialists of the GOA gather information on trade remedy actions and engage in negotiations with investigating Members.

The IA of the GOA could also help Azerbaijani companies when it becomes a target of trade remedy investigations by another Member. Frequently, foreign respondents face significant logistical burden when a trade remedy investigation is initiated against them. Companies from the developing countries are particularly vulnerable. As a result, sometimes these companies simply determine to give up defending themselves and discard the market as they do not have legal or financial resources to fight back.

The IA of the GOA could contemplate providing legal, logistical and financial support to these companies. It is almost not feasible for an Azerbaijani company to find a lawyer and other specialists to defend itself in an antidumping investigation. Hiring lawyers and other specialists requires financial resources to finance the arrangement and relevant experience to utilize them that maximize the benefit of the legal service. Azerbaijani companies will not be in a position to satisfy these requirements in early stage of the WTO entry. So, it is likely that the company will not be able to defend itself vigorously or that sometimes it will reluctantly decide

to give up the market. Under the circumstances, the IA of the GOA could provide essential support for Azerbaijani companies in this regard.

One thing to note in this respect, however, the GOA should be careful not to violate subsidy norms of the WTO. The SCM Agreement provides for detailed provisions which prohibit government's support for the private sector. Thus, the GOA should attempt to maneuver through the subsidy rules not to violate a provision of the SCM Agreement. For instance it may probably avoid a subsidy claim by ensuring that specificity requirement does not exist.

## 6. Conclusion

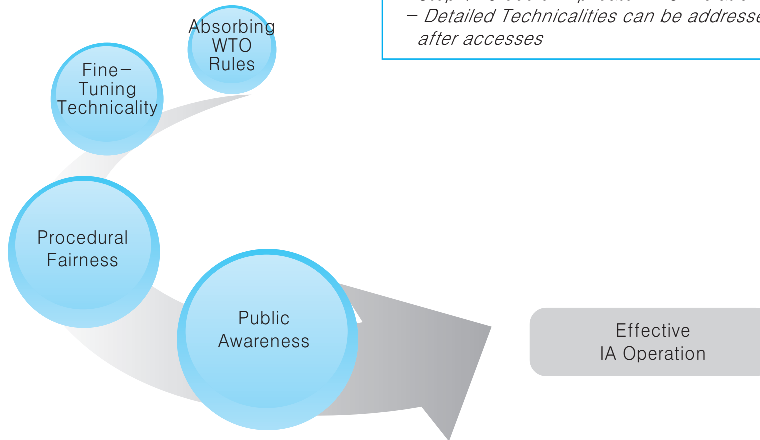
Given that Azerbaijan has already received suggestions and proposals from the United States and the European Communities about measures to be taken in preparation for the WTO entry, it is critical for the GOA to sort out various suggestions and take the best measure for it in the future. It may be the case that the suggestions or proposals of these well established countries would be hard or difficult to accept or implement from the perspective of Azerbaijan. On the other hand, Korea's experience would provide additional benefit to Azerbaijan in this regard, stemming from Korea's unique experience in establishing and maintaining IAs and related procedures.

In conclusion, it is important for Azerbaijan to introduce, update and fine-tune its statutes and regulations regarding the trade remedy measures as soon as possible. This is important for two reasons. First, the updates and fine-tuning of provisions would make the statues, regulations and practices of Azerbaijan completely compatible with its respective obligations under the WTO. At the same time, such fine-tuning and improvements would certainly help the GOA develop and maintain reasonable and predictable trade remedy measures in the long run. The importance of reasonable and predictable trade remedy measures cannot be overemphasized given the trade volume to be increased in the immediate aftermath of the WTO accession and the nature as the only available alternative for all WTO Members under the WTO regime. A reliable and effective IA is the cornerstone of successful integration into the WTO regime for any new Member.

GOA has achieved a lot already in an effort to expedite the accession process. The GOA, at the same time, will have to come up with more strategic thinking in formulating the basic structure of the IA inside the GOA. Also, the establishment and operation of the IA cannot be done through simple legislations and regulations on trade remedy measures. Rather, the legislations and regulations in other related areas should also be reviewed and amended as necessary.

## 4 Steps for Effective IA Administration

- *Step 1–3 could implicate WTO Violation*
  - *Detailed Technicalities can be addressed after accesses*



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Chapter 04

# The Strategies for Industrial Diversification through Export Promotion

1_ Introduction
2_ Diagnostics for Export Structure of Azerbaijan
3_ Exports Based Industrial Diversification: Lessons from Korea
4_ Industrial Policies under the WTO Era
5_ Policy Suggestions
6_ Concluding Remarks
Annex

Chapter 04

# The Strategies for Industrial Diversification through Export Promotion

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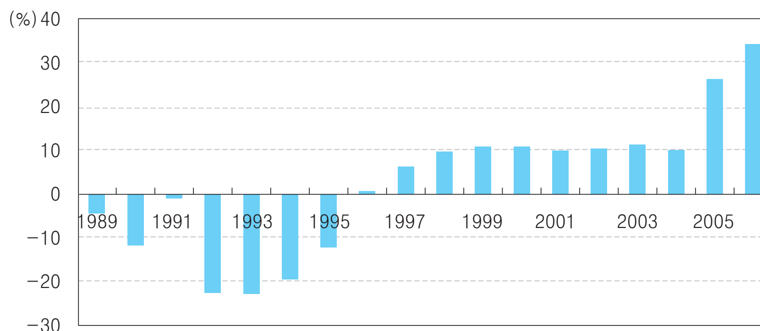
## 1. Introduction

### 1.1. Growing Concerns over Industrial Structure of Azerbaijan

Azerbaijan has experienced fast and strong economic growth with annual GDP growth rates of more than 10 percent since the late-90s, as depicted in Figure 4-1. Recently, real GDP growth has been further accelerated, reaching at 26.4 percent in 2005 and 34.5 percent in 2006. Consequently, Azerbaijan is now posited as the fastest growing economy in the world. Severance from the Soviet Bloc after independence in 1991 caused massive economic turmoil

**Figure 4-1** | Recent Trend of GDP Growth Rates (Annual change, %)



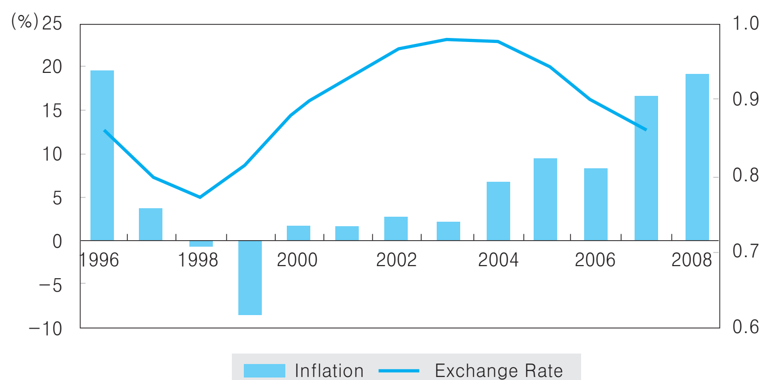

Source: EBRD database

and stagnation until the mid-1990s, but the Azerbaijani economy quickly rebounded, thanks to macroeconomic stability and oil windfalls.

The recent resurgence of Azerbaijan has been in fact largely attributable to oil/gas production and construction booms. The Azerbaijan International Operating Company (AIOC), led by British Petroleum, has been expanding oil production in the Azeri-Chirag-Guneshi offshore complex. As a result, Azerbaijani oil production increased by 41 per cent in 2005 and 45 percent in 2006. Recently the construction of Baku-Tbilisi-Ceyhan pipeline has been completed and thus oil production is expected to be even higher.

Even though oil boom led to exceptionally high economic growth and a significant improvement in its external position, it induced several structural problems in the Azerbaijani economy. Most importantly, Azerbaijan is showing various symptoms of the so-called "Dutch Disease."[1] Real effective exchange rate continues to appreciate since 2004, and the inflation rates are recently ramping up to 2-digit figures, which in turn erodes the cost competitiveness of non-energy sectors(See Figure 4-2). The rapid expansion of government spending, combined with the maintenance of artificial public monopolies are further exacerbating the situation.

**Figure 4-2 | Recent Trend of Inflation and Exchange Rates (Annual Change, %)**



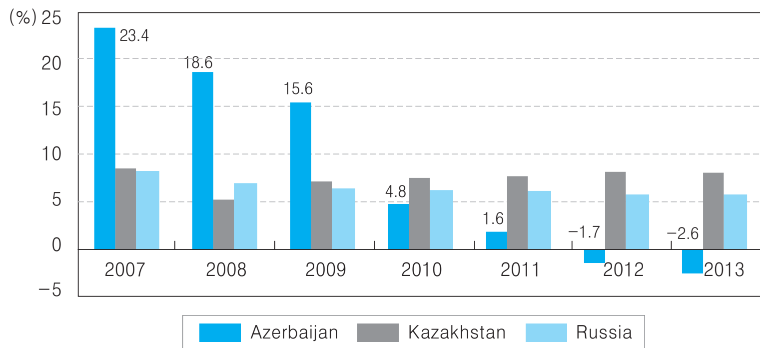

Notes: The exchange rate depicted in the figure is a Manat per US dollar. The figures for 2007 and for 2008 are an estimate and a projection, respectively.
Source: EBRD database

1. The term "Dutch Disease" was originated from the decline of the manufacturing sector in the Netherlands after the discovery of natural gas in the 1960s.

According to the IMF (2007)'s estimates, oil production boom will peak in 2009-10 unless new oil deposits are discovered. As presented in Figure 4-3, IMF forecasts that, with other things being equal, the economic growth rate will continue to decline and possibly record minus figures in 2012-13, while neighboring countries such as Russia and Kazakhstan will continue to maintain stable economic growth.

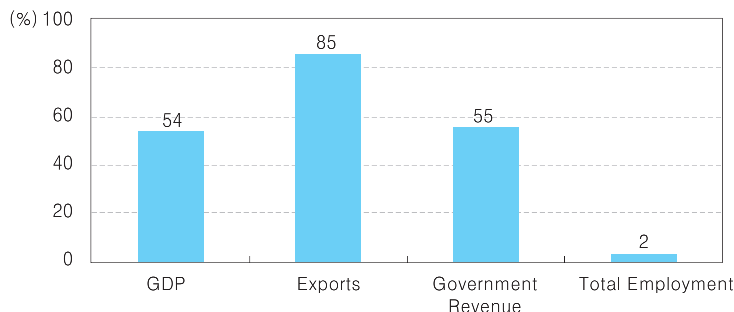
Although there is no universal definition for a resource-based economy, it is often regarded as an economy for which natural resources account for more than 10% of GDP and 40% of exports. Taking this definition we can assume that Azerbaijan is a typical case of a resource-based country. Figure 4-4 presents the importance of the energy sector in the Azerbaijan economy. The energy sector accounts for about 54 percent of GDP and 85 percent of total

**Figure 4-3 | Forecasts of GDP Growth Rate (Annual change, %)**




Source: IMF, World Economic Outlook

**Figure 4-4 | The Importance of Energy Sector (as of 2006, %)**



exports. Furthermore, more than a half of public expenditures is mostly spent on the development of infrastructure. On the other hand, the energy sector accounts for merely 2 per cent of total employment.

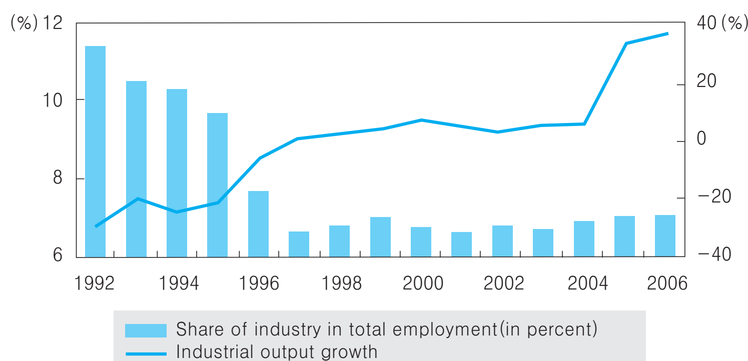
## 1.2. Why is Industrial Diversification Important?

To attain sustainable growth in the medium- and long-term periods, it is often suggested that a resource-based economy needs to develop non-resource sectors. Then a natural question arises; why is industrial diversification so important?

As Ahrend(2006) adequately explains, there are various economic problems surrounding a resource-based economy on the verge of massive oil boom: First of all, the economy is prone to the vulnerability of external shocks, especially to volatile commodity prices in the world market. Many developing countries often face a great degree of trade shock caused by a sharp fall in the commodity prices of their major production, but the risk of macroeconomic destabilization caused by such kind of shock is particularly high for resource-based economies. Furthermore, even in the case when commodity prices are rising, these economies tend to suffer from high inflation and thus, economic stability is eroded.

Second, the Dutch Disease becomes a more serious problem for an economy if the weight of an existing resource sector in exports increases relatively fast. In such circumstances, the increase in revenues from resource exports causes the real effective exchange rate to appreciate and to raise wage levels, which are detrimental to the cost competitiveness of non-oil manufacturing sectors.

**Figure 4-5 | Industrial Output Growth vs. Employment Share**




Source: EBRD database

Third, the resource sector provides relatively little opportunity for employment. As aforementioned, the energy sector in Azerbaijan accounts for more than a half of GDP, but only 2.1% of total employment. As reported in Figure 4-5, the share of manufacturing in total employment has remained at around 6-7 percent since the late-1990s, while industrial output, thanks to the oil boom, grew at more than 30 percent for 2005-06.

Fourth, the extraction of natural resources itself, once extraction facilities are established, is rather a low-tech undertaking and thus there is little room for technological progress. There surely exists high technological knowledge specific to resource extraction, but in reality such knowledge often belongs exclusively to advanced countries.

Finally, resource-based economies have the risk of suffering from moral fallout, which results in institutional weakness. Resource rents generated by the resource extraction are nature's blessing but they are often wasted or appropriated by vested interest groups. Natural resources are easy to monopolize and thus contests to control them are more likely to be a zero-sum game. This increases the incentives for state elites to nationalize resource industries. In such circumstances, public services themselves are more likely to be entangled with business interests, which heightens the risk of corruption.[2]

For a resource-based economy to be completely free from all of the aforementioned problems seems virtually impossible in reality, but there are certain ways to avoid some of them and to reduce the risk for the others. In the short run, appropriate macroeconomic policies combined with sound management of foreign exchange rates help to mitigate the impacts of external shocks. A counter-cyclical fiscal policy with respect to commodity prices would be quite effective, for example, through establishing and maintaining stabilization funds financed by revenues from natural resources. However, more importantly, structural transformation towards a diversified industrial structure is essential, especially from the medium and long-term perspective to gain stable and sustainable economic growth. Natural resources could support a relatively long-lived economic boom, but they should be regarded as a transitory rather than permanent source of economic growth.

Industrial diversification certainly helps to reduce the economy's vulnerability to external price shocks for a specific sector(s). Certain manufacturing sectors offer greater opportunity for creating new jobs than resource sectors. There exist some sectors that contain higher forward and backward linkage to the rest of the economy and greater technological progress than resource sectors. In this respect, industrial diversification strategy is a key element for long-term

2. Deacon and Mueller(2004) suggest that an abundance of point resources, such as mineral deposits, is more likely to lead to weak political systems and consequently economic disadvantage than diffuse resources, like fisheries or forests.

sustainability.

In the case of Azerbaijan, recent oil windfalls created some positive spillovers to non-oil sectors, such as machinery, chemicals, construction and telecommunication.[3] However, these sectors still account for quite a small portion of GDP. In addition, there are few sectors that have competitive edge in the world market.

## 1.3. How to Achieve Industrial Diversification?

The challenge of industrial diversification is quite daunting, and thus achieving industrial diversification is a rather difficult task. However, recent history provides some useful guidance suggesting the effectiveness of the export-based industrial diversification, especially for a country of which its domestic market size is relatively small, like Azerbaijan.

For example, East Asian countries, such as Japan, Korea and recently China among many others, have recorded the most impressive economic growth over the last half of the 20th century. Their experience indicates the strong linkage of export orientation with rapid economic growth and industrial diversification. In most cases, high and sustainable growth was preceded by shifts from traditional import substitution to more export-oriented and outward-looking policies.

It should be noted, however, that there is no “one-size-fits-all” strategy for industrial diversification. As explained in detail later in this paper, industrial strategies are quite divergent across the fast-growing East-Asian countries. Which is the most appropriate plan, mainly depends on the economic pre-conditions of an economy and on global economic environments that the country faces.

Therefore, it is important to identify ‘what to do’ and ‘what to avoid’ lists for an industrial diversification strategy, based on current domestic economic conditions of Azerbaijan. For this purpose, looking at the experiences of other countries that succeeded in achieving industrial diversification is useful. In addition, it is also important to carefully investigate international environments and rules, such as the WTO Subsidies Code, in order to mitigate conflicts with other countries. In this context, this paper provides useful information on these areas in order to assist Azerbaijan in preparing appropriate strategies for industrial diversification.

3. The non-oil sector grew by about 12 percent on average for 2005-2006.

## 1.4. In which Aspects could the Korean Experience be Useful?

Korea has emerged from one of the poorest agrarian economies into an industrialized country, mainly through an export-based industrialization strategy. Exports grew accompanied by a considerable diversification in both the commodity structure of domestic production and exports. This implies that the Korean experience could be a good reference point for Azerbaijan in setting up diversification strategies.

It should be kept in mind that the 'post-WTO' global context that Azerbaijan is currently facing is quite different from the one that Korea experienced. Many of the promotional measures taken by the Korean government during the rapid economic growth period cannot be used by developing countries now. This indicates tougher conditions for pursuing industrial policy under the WTO era than before.

Furthermore, economic pre-conditions are different from each other. For example, the modern Korean history of economic development has had so many struggles against the foreign exchange shortages to finance domestic investment resources. On the other hand, Azerbaijan has rich natural resources, including considerable oil reserves, and a relatively developed industrial sector, compared with the time when Korea started to pursue export promotion in the 1960s, and most importantly, massive foreign exchange reserves to finance the economic development.

In this respect, this paper will not discuss much about export promotion measures that Korea has adopted. Main lessons from the Korean experience on which we'd like to focus here is rather the institutional systems, helping to effectively implement diversification strategies in Korea during the early stages of economic development.

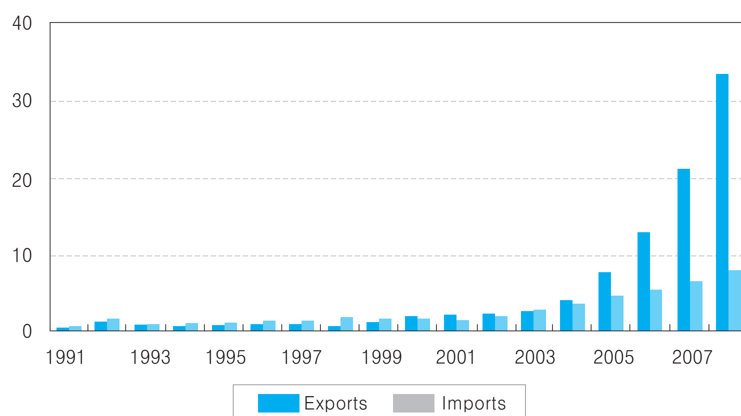
The rest of the paper proceeds as follows: Section 2. presents a brief diagnostics of the export structure of Azerbaijan and some policy implications for industrial diversification through export promotion. Section 3. introduces the Korean experiences on export-based industrial diversification, focusing on institutional and infra-structural aspects. Then, Section 4. discusses the direction of industrial policies under the WTO era. Furthermore some policy suggestions are summarized in Section 5. Finally, Section 6. concludes the paper.

# 2. Diagnostics for Export Structure of Azerbaijan

## 2.1. Export Composition of Azerbaijan

Figure 4-6 reports the recent trend of Azerbaijani trade for the periods of 1991-2008. As depicted in the figure, recent export performance is very impressive. Exports grew at 104.4 per cent and 70.1 percent for 2005 and 2006, respectively. Consequently, the export revenues soared from 3.7 billion US dollars in 2004 to 13.0 billion US dollars in 2006.[4] According to EBRD' projection, Azerbaijani exports will increase about two and a half-fold for the periods of 2006-08.

**Figure 4-6 | Recent Trend of Exports and Imports (US billion $)**




Notes: The figures for 2007 and for 2008 are an estimate and a projection, respectively.
Source: EBRD database

Obviously, the recent soaring of exports are almost exclusively due to the oil boom. While the composition of exports remained in favor of energy-related sectors since independence, one interesting feature within the sector is the share of crude oil in total oil-related exports becoming larger (See Table 4-1). That is, until the late 1990s, some processing, such as oil refinery, had been done before exporting. Recently, however, crude oil itself is directly exported without further domestic processing, mainly due to the construction of new oil pipelines. This implies that there may be even less spillover effect from the oil sector to the rest of the economy.

4. There exists non-negligible difference in export figures between IMF's estimates an EBRD's estimates. While the figures for 2004 are rather close to each other ($3.6 billion vs. $3.7 billion), EBRD's estimates ($7.6 and $13.0 billion for 2005-06, respectively) are much bigger than those of IMF's ($4.3 and $6.4 billion).

**Table 4-1 | Export Composition by Type of Goods (%)**

| | | 1996 | 1998 | 2000 | 2002 | 2004 | 2006 |
|---|---|---|---|---|---|---|---|
| Primary | | 9.1% | 30.3% | 59.7% | 69.8% | 64.3% | 61.4% |
| | (Crude oil, etc.) | n.a. | (24.7%) | (56.5%) | (68.1%) | (62.6%) | (60.5%) |
| Intermediate | Semi-manufactured | 77.1% | 55.5% | 35.4% | 25.4% | 27.2% | 32.2% |
| | (Oil and Gas) | (65.4%) | (43.9%) | (28.6%) | (20.6%) | (19.5%) | (24.0%) |
| | Parts and Accessories | 2.2% | 2.9% | 1.1% | 1.3% | 0.6% | 0.3% |
| Final | Capital goods | 3.9% | 3.0% | 1.4% | 0.8% | 4.1% | 1.7% |
| | Consumption goods | 7.7% | 8.2% | 2.4% | 2.7% | 3.7% | 4.4% |

Note: Products are classified by the United Nation's BEC (Broad Economic Categories) codes.
Source: The United Nation, COMTRADE database

As for the destination of Azerbaijani exports, Italy is the largest importer for Azerbaijani exports in 2006, followed by Turkey, France, Russia and Iran. As reported in Table 4-3, Italy is the major importer of Azerbaijani mineral fuels, oil and distillation products. In fact, more than a half of the total oil exports of Azerbaijan are destined for Italy.

**Table 4-2 | Top 5 Trading Partners**

| Year | Rank | Exports | | | Imports | | |
|---|---|---|---|---|---|---|---|
| | | Country | Value | Share | Country | Value | Share |
| 1996 | 1 | Iran | 226 | (35.8) | Turkey | 216 | (22.5) |
| | 2 | Russia | 111 | (17.6) | Russia | 158 | (16.4) |
| | 3 | Gerogia | 92 | (14.6) | UAE | 109 | (11.3) |
| | 4 | Tureky | 39 | (6.2) | Ukraine | 94 | (9.8) |
| | 5 | Turkmenistan | 34 | (5.4) | Germany | 77 | (8.0) |
| 2001 | 1 | Italy | 1,324 | (57.2) | U.S.A. | 231 | (16.1) |
| | 2 | Israel | 164 | (7.1) | Russia | 153 | (10.7) |
| | 3 | Georgia | 103 | (4.5) | Turkey | 148 | (10.3) |
| | 4 | Spain | 102 | (4.4) | Turkmenistan | 135 | (9.4) |
| | 5 | Island | 86 | (3.7) | Kazakhstan | 100 | (6.9) |
| 2006 | 1 | Italy | 2,845 | (44.7) | Russia | 118 | (22.4) |
| | 2 | Turkey | 388 | (6.1) | U.K. | 454 | (8.6) |
| | 3 | France | 348 | (5.5) | Germany | 404 | (7.7) |
| | 4 | Russia | 344 | (5.4) | Turkey | 385 | (7.3) |
| | 5 | Iran | 296 | (4.6) | Turkmenistan | 369 | (7.0) |

Note: Products are classified by the United Nation's BEC (Broad Economic Categories) codes.
Source: The United Nation, COMTRADE database

Other than oil products, Azerbaijani exports are mostly destined for CIS countries and other neighboring countries, such as Turkey and Iran. Table 4-3 presents top 10 exporting products of Azerbaijan, classified by the HS (Harmonized Systems) 2-digit codes. First of all, we can see that Azerbaijani exports are quite concentrated in the oil sector, accounting for 84.6% of the

**Table 4-3 | Top 10 Exporting Products of Azerbaijan (2006)**

(Unit: million US dollars)

| HS code | Industry | Exports in value | Share in total exports | Share of top 3 markets | Net Trade |
|---|---|---|---|---|---|
| 27 | Mineral fuels, oils, distillation products, etc | 5,390 | 84.6% | Italy (52.5%)<br>Israel (12.7%)<br>France (6.4%) | 4,777 |
| 28 | Inorganic chemicals, precious metal compound, isotopes | 157 | 2.5% | Tajikistan (82.1%)<br>Hong Kong (16.6%)<br>Georgia (0.9%) | 127 |
| 39 | Plastics and articles thereof | 100 | 1.6% | Turkey (33.0%)<br>Russia (16.3%)<br>Netherlands (9.9%) | 12 |
| 08 | Edible fruit, nuts, peel of citrus fruit, melons | 99 | 1.5% | Russia (72.5%)<br>Italy (11.0%)<br>Germany (6.5%) | 91 |
| 89 | Ships, boats and Other floating structures | 73 | 1.1% | Kazakhstan (98.6%)<br>Turkmenistan (1.3%)<br>U.K. (0.1%) | -311 |
| 76 | Aluminum and articles thereof | 71 | 1.1% | Iran (40.2%)<br>Hong Kong (34.5%)<br>Turkey (11.3%) | 54 |
| 15 | Animal, vegetable fats and oils, cleavage products, etc | 63 | 1.0% | Russia (91.1%)<br>Georgia (4.2%)<br>Tajikistan (2.3%) | 23 |
| 52 | Cotton | 43 | 0.7% | Russia (62.3%)<br>Turkey (15.4%)<br>Latvia (10.6%) | 42 |
| 73 | Articles of iron or steel | 36 | 0.6% | Kazakhstan (28.6%)<br>Russia (23.5%)<br>Turkmenistan (12.8%) | -388 |
| 07 | Edible vegetables and certain roots and tubers | 33 | 0.5% | Russia (98.0%)<br>Ukraine (1.2%)<br>Georgia (0.8%) | 22 |

Source: The United Nation, COMTRADE database

total exports. Oil products are mainly destined for European countries such as Italy and France, etc., and Israel. Second, the non-oil exports are still mostly related to primary products. Ships, boats and other floating structures (HS 89) are among the top 10 exports, but the net trade value is negative, which implies that Azerbaijan imports more than exports.

Third, not only are exports quite concentrated in terms of product composition, but this is only true for export destinations as well. Table 4-3 shows that the destinations of the top 10 exports are quite concentrated on a single country or so. For example, inorganic chemicals, precious metal compound and isotopes (HS 28) are mostly destined to Kazakhstan (82.1% of the total exports). The only few exceptions are plastics (HS 39), aluminum (HS 76) and articles of iron or steel (HS 73). At the same time, however, even these products are mostly destined for top 3 exporting markets. These observations will serve as very important information when we discuss about comparative advantage of Azerbaijani exports in the following.

## 2.2. Sectors of Comparative Advantage

Azerbaijan used to have comparative advantage in some manufacturing sectors, notably agro-processing products and machinery for oil extraction, before the collapse of the Soviet Union. These products were mainly destined for the rest of the Soviet Union. The collapse left Azerbaijan with the loss of their major export markets and with excessive capacity. Industrial production in these non-oil sectors had steadily declined until the late 1990s. According to Navaretti(2003), the real output of machine building in 1997, which contains machinery for oil extraction that Azerbaijan had comparative advantage before the independence, stood at 20.4 percent of its level in 1992 and declined further up to 12.3 percent of 1992 in 2000.

Even though recent oil windfalls created some positive spillovers to non-oil sectors, as mentioned before, the non-oil sector largely remains stagnant with a small portion of industrial output.

The Center of Economic Reform (2004, hereafter CER) at the Ministry of Economic Development of Azerbaijan recently examined comparative advantage of Azerbaijani exports, using an extensive set of trade measures. Based on the computation using the Balassa Revealed Comparative Advantage (RCA) indices, they found that Azerbaijan currently has comparative advantage in the following sectors:

- Agriculture (tobacco, nuts, tea, vegetables, cotton, oil seeds, etc.);
- Agro-processing (fruit juices, cigarettes, animal skins, semi-processed cotton, etc.);
- Oil industry (kerosene and medium oils, motor spirit and light oils, fuel oils, etc.);
- Chemical and Petrochemical industry (ethylene, polyethylene, plastics, etc.)

Given these findings, they suggest that government policies should support the development of these sectors that are competitive in world markets and will be the key sectors for the creation of new jobs. Admittedly, this is quite a valuable research for preparing export-promotion strategies, and we agree with most of the results that they have reached.

However, there is one important aspect that they overlooked: Are these products really competitive in world markets, including in those of advanced countries? As shown in Table 4-3, for the sectors that CER (2004) identified as those of comparative advantage, most of the Azerbaijani exports are destined for CIS countries or the neighboring countries. It is hard to find manufacturing sectors with comparative advantage vis-á-vis the world markets, while most of the manufactured products are exported to CIS countries. This indicates that the comparative advantage for these sectors is in fact local, instead of global. This is quite an important observation, since this implies that simply promoting exports of these products does not guarantee competitiveness in the world markets. Success of export promotion strategy is clearly related to the question of how Azerbaijani exports meet the demand structure of other countries in the world.

In this context, we investigate here the correlation between Azerbaijani export specialization and other countries' import specialization, using the Commodity Complementarity Indices (hereafter CCI). CCI correlates economy $j$'s export specialization pattern with economy $j$'s import specialization pattern across the spectrum of all trade products (See Box 1, for more detail). We do this for the European Union, the U.S., Russia and the CIS countries (other than Russia), respectively.

### Box 1. Commodity Complementarity Index (CCI)[5]

Commodity Complementarity Index (CCI hereafter) correlates economy $j$'s export specialization pattern with economy $j$'s import specialization pattern across the spectrum of all trade products. CCI is a trade-weighted measure for sector $s$ of the degree to which the relative export share structure of economy $j$'s exports ($RXS^k_i$) corresponds with the relative import share structure of economy $j$'s imports ($RMS^k_j$) across all $k$ commodities within the sector.

$$CC^s_{ij} = \sum_{k \in s} \left[ \theta^k \times RXS^k_i \times RMS^k_j \right]$$

where

$\theta^k \equiv \dfrac{X^k_{ww}}{X^s_{ww}} \equiv$ share of product $k$ in sectorfor global exports

5. The key reference for the contents of this box is Vollrath and Johnston (2001).

$$RXS_i^k \equiv \frac{X^k{}_{iw}/X^s{}_{iw}}{X^k{}_{ww}/X^s{}_{ww}} \equiv$$ share of $k$ in sector $s$ for $j$'s exports, relative to share of $k$ in sector $s$ for global exports

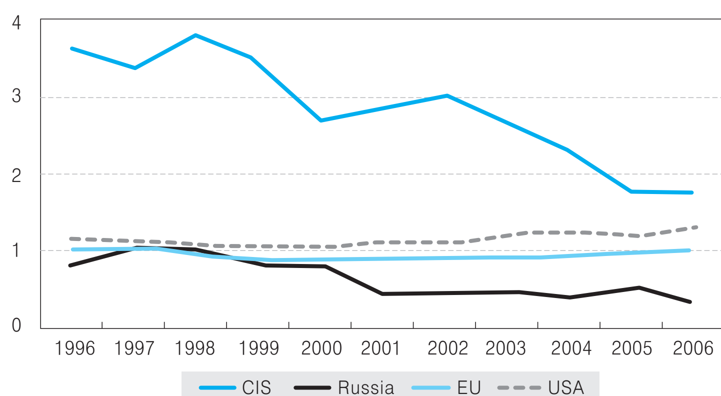
$$RMS_j^k \equiv \frac{M^k{}_{jw}/M^s{}_{jw}}{M^k{}_{ww}/M^s{}_{ww}} \equiv$$ share of $k$ in sector $s$ for $j$'s imports, relative to share of $k$ in sector $s$ for global imports

Note that $RXS_i^k$ is Balassa's revealed comparative advantage indices that CER(2004) used in their analysis. CCI equal to one represents a threshold, with a value greater (less) than one showing a greater (lesser) level of complementarity in the composition of what exporter $i$ exports and what importer $j$ imports than the average pair of countries.

Figure 4-7 presents our computation results.[6] As we can see in the figure, the correlation of Azerbaijani exports with the import structure of the CIS countries is greater than those with Russia, the EU and the U.S., over the entire time span. This implies that Azerbaijani exports destined for the CIS countries show a greater complementary relationship with local demands than the other cases. On the other hand, Russia's CCI has a value less than one, which indicates a lesser level of complementarity in the composition of what Azerbaijan exports and what Russia imports than the average pair of countries.

Another interesting finding is that complementary relationship between Azerbaijani exports

**Figure 4-7 | CCIs for Selected Countries (All Sectors)**




Source: Author's calculation based on UN Comtrade database

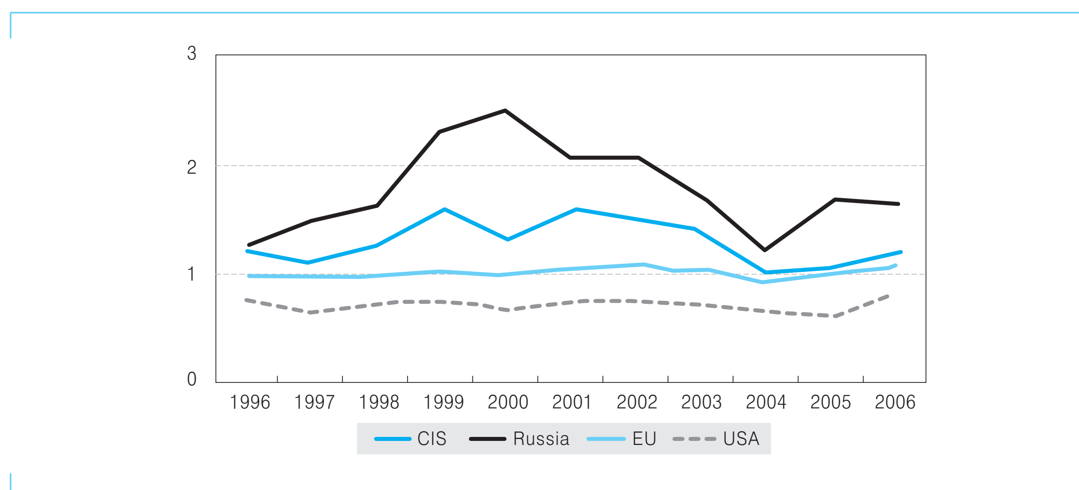
6. In computation, HS-6 digit and HS-2 digit are regarded as individual commodity level,, and sector level,, respectively.

and the import structure of the CIS countries is steadily declining for the sample period of 1996-2006. On the other hand, CCIs for the U.S. and the EU have been improved over time.

The aforementioned findings of changes in the complementary relationships among the major trading partners may result from the high dependency of Azerbaijani exports on the oil sector. The reasons why CCIs for the U.S. and the EU have been improved over time could be attributable to rapid growth of oil exports. In this regard, we re-calculate CCIs for the whole sector excluding the oil sector.

As depicted in Figure 4-8, now Russia becomes a country which its import structure is closely linked to Azerbaijani exports, relative to the others, when we exclude the oil sector. The CIS countries are posited right after Russia, still showing higher complementarity than the EU, the U.S. or the average pair of countries in the world. Finally, exports destined for CIS countries and for Russia reveal deeper bilateral complementarity for the periods of 2004-06 than the previous years.

**Figure 4-8 | CCIs for Selected Countries (Oil sector excluded)**




Source: Author's calculation based on UN Comtrade database

Annex A1 contains information on the degrees of export specialization for top 10 exporting products (HS 2-digit) of Azerbaijan in 2006. According to Balassa's RCA indices, most of the top 10 exporting products reveal comparative advantage, except plastics (HS39) and articles of iron or steel (HS 73). As we expect, oil exports shows the highest comparative advantage, followed by chemicals (HS 28), edible fruit (HS 08) and so on.

Lafay index analysis produces similar results, except for ships, boats and other floating structure (HS 89) have now comparative disadvantage because of negative net trade

balance.[7] Articles of iron or steel (HS 73) also show comparative disadvantage.

On the other hand, the stories turn out quite differently when we compute CCIs for each of the major export destination. For example, in the case of chemicals (HS 28), which reveals comparative advantage for both RCA and Lafay indices, the Azerbaijani exports maintain a higher complementary relation only with the import demand structure of Russia than the average pair of countries.

For animal, vegetable fats and oils, cleavage products, etc. (HS15), cotton (HS 52), articles of iron or steel (HS73) and edible vegetables and certain roots and tubers (HS 07), the import structure demands of both CIS countries and Russia are strongly correlated with Azerbaijani exports. For the EU, only do so in the cases for aluminum (HS 76) and edible vegetables and certain roots and tubers (HS 07). Finally, for the U.S., only oil exports show complementarity.

## 2.3. Obstacles of Export Promotion

Lucke and Rothert(2006) recently investigated the pattern of Central Asia's comparative advantage in international trade, based on factor prices and transport costs, historical production patterns, and the recent trends in geographical and product compositions of Central Asian trade.

One of the important findings is that resource-rich countries like Azerbaijan and Kazakhstan are hardly able to compete on price in labor-intensive exports to the world market. This is mainly due to the recent rise of average wage levels in those countries as a byproduct of oil windfalls. According to International Labor Organization (ILO)'s estimates, the monthly wage level of Azerbaijan (US$198) in 2005 is already close to that of China (US$220). Given the recent surge of oil production in Azerbaijan, the former will soon surpass the latter.

Another finding is that geographical remoteness and high transport costs hamper to expand exports by integrating into global production networks operated by European firms. Such strategies have been proven to work for Central and Eastern European countries, but clearly not for Central Asian economies. Furthermore, the current situation is especially disadvantageous for small exporters in Central Asia, because road and air transports are approximately twice as expensive, and rail/sea transports up to 4 times as expensive, as for large exporters.

Azerbaijan is not an exception in this aspect. As Navaretti(2003) precisely discusses,

7. If RCA index turns to be above 1 but Lafay index to be below 1 for a certain sector, this implies that imports for this sector exceed its exports, even though the latter, compared to the world's average, accounts for a relatively larger portion of total exports for an economy.

transportation costs are one of the biggest obstacles in promoting Azerbaijani exports to the major markets in the world. Azerbaijan is a land-locked country and thus the transportation system has a transnational dimension. According to Navaretti(2003), the only viable trade route for Azerbaijan to get access to the major markets in the world is through Georgia and then on to Russia or to the Black Sea. Because of Georgia's infra-structural and political weakness, the Georgian corridor is a major bottleneck for Azerbaijani trade.[8] These all indicate that Azerbaijan can hardly find a way to expand exports by integrating into global production networks.

## 2.4. Implications: Some Guidance for Export Promotion

Basing on observations so far, we can conclude the following: for the short and medium term, it may remain relatively difficult for Azerbaijan to gain competitiveness in European and North American markets through exports of own designed manufacturing products. Even though certain non-oil products are shown to have comparative advantage, in fact, exports of these goods are highly concentrated on the CIS countries.

One explanation on weak competitiveness in the non-oil sector is geographical remoteness and high transportation costs. Another one is the high and growing wage level, as a symptom of the Dutch Disease, which leads to eroding price competitiveness in the world market.

Taking into consideration that Azerbaijan is facing lack of cost competitiveness, infra-structural weakness as well as technology/marketing gaps compared to advanced countries, we recommend the following: At least for the short and medium terms, Central Asian (and former CIS) markets and some of the neighboring countries such as Turkey and Iran should be used as a test bed for exports of the non-oil products. In these markets, Azerbaijan already shows a certain degree of comparative advantage. Furthermore, as suggested by the CCI analysis in the previous section, Azerbaijani exports destined for the CIS countries show greater complementary relationship with local demand. These markets are rapidly growing and thus have great potential for import demands, thanks to the recent rise of oil/commodity prices.

Meanwhile, Azerbaijan should also make an effort to develop the non-oil sectors for long-run sustainability. For this purpose, attracting Foreign Direct Investment (hereafter FDI) into the non-oil sectors should be an excellent policy option. It is often argued that FDI offers recipient economies with important potential benefits in the form of technology transfer, capital inflows and improved access to export markets, among many other things.

8. According to Navaretti (2003), containers travel by rail between Baku, the capitol city of Azerbaijan, and Poti, the main Georgian port on the Black Sea, at an average speed of 20 kilometers per hour.

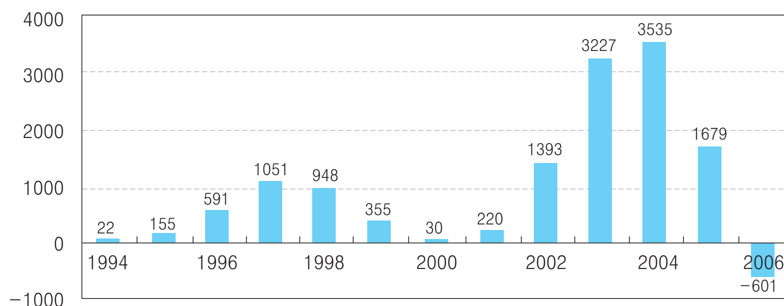
Export Processing Zones (EPZs) could be a viable and effective option for FDI attraction and economic diversification. EPZs serve as enclaves where obstacles to business development in the rest of the country can be bypassed. That is, they could be islands of good institutions and infrastructure with a certain degree of fiscal and financial incentives to foreign or domestic firms (clusters). Radelet(1999) argues that no country has ever been able to rapidly expand manufacturing exports without an export platform.

## 2.5. Recent Trend of Foreign Direct Investment into Azerbaijan

Before closing this section, let's briefly discuss the current characteristics of FDI inflows into Azerbaijan. FDI inflows increased dramatically for 2002-2004, with the peak of $3.5 billion US dollars in 2004 (See Figure 4-9). As a result, FDI stocks per GDP reached at 66.9 per cent, which is far higher than the developed countries' or even developing countries' average(24.7 percent and 26.7 percent, respectively), as shown in Table 4-4.

According to UNCTAD (2007), Azerbaijan has far over-performed in its potential as an FDI destination. As of 2005, Azerbaijan was ranked 65th out of 141 countries based on potentially attracting FDI, but Azerbaijan's actual FDI inflows compared to its domestic market size ranked at 1st in the world.[9]

**Figure 4-9 |** FDI Inflows (US million $)




Source: UNCTAD, FDI database

9. The UNCTAD Inward FDI Performance Index is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. On the other hand, the UNCTAD Inward FDI Performance Index is based on 12 economic and structural variables, including GDP per capita, the GDP growth rate, the export share in GDP, telecom infrastructure, the share of R&D expenditure in gross national income, the share of tertiary students in the population, etc.

**Table 4-4 | Inward FDI Performance**

| | FDI Stocks per GDP (2006) | FDI Flows per Gross Fixed Capital Formation(2006) | FDI Potential Ranking(2005) | FDI Performance Ranking(2005) |
|---|---|---|---|---|
| Azerbaijan | 66.9 | -9.6 | 65th | 1st |
| Kazakhstan | 42.0 | 27.6 | 49th | 28th |
| Russia | 20.2 | 16.3 | 22nd | 89th |
| Ukraine | 21.1 | 21.0 | 48th | 35th |
| Developed | 24.2 | 11.8 | - | - |
| Developing | 26.7 | 13.8 | - | - |
| Transition | 26.5 | 14.5 | - | - |

Note: Rankings are out of 141 countries.
Source: UNCTAD, World Investment Report, 2007

But here is the problem surrounding FDI inflows in the case of Azerbaijan; like exports, FDI inflows into Azerbaijan are heavily concentrated on the oil-sector. As of 2002, FDI inflows into the oil sector account for 71.4 percent of the total inward FDI.

**Table 4-5 | FDI Inflows by Industry (1995-2002)**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|
| Total | 330.1 | 627.3 | 1,114.8 | 1,023.0 | 510.3 | 129.9 | 226.5 | 1,392.4 |
| Primary | 301.4 | 452.8 | 828.3 | 831.6 | 349.2 | -5.7 | 125.4 | 993.8 |
| Petroleum | 301.4 (91.3%) | 452.8 (72.2%) | 828.3 (74.3%) | 831.6 (81.3%) | 349.2 (68.4%) | -5.7 (-) | 125.4 (55.4%) | 993.8 (71.4%) |
| Unspecified | 28.7 | 174.5 | 286.5 | 191.4 | | 135.6 | 101.1 | 398.6 |

Note: Petroleum refers to the oil sector, while unspecified refers to the non-oil sector.
Source: UNCTAD, FDI database

## 3. Export-based Industrial Diversification: Lessons from Korea

As aforementioned, Korea has emerged from one of the poorest agrarian economies into an industrialized country, mainly through an export-based industrialization strategy. Exports grew accompanied by a considerable diversification in both the commodity structure of domestic production and exports. This implies that the Korean experience could be a good reference point for Azerbaijan in setting up diversification strategies

As we also discussed above, however, industrial strategies are quite divergent across the fast-growing East-Asian countries. Table 4-6 contains the characteristics of industrial policies pursued by East Asian countries.

**Table 4-6 | Characteristics of Industrial Policies for Selected East Asian Countries**

| | Japan | Korea | Taiwan | Singapore |
|---|---|---|---|---|
| Export promotion | Strong | Very strong | Very strong | Strong but mostly indirect |
| State-owned firms in manufacturing | Not used | Some critical industries | Key upstream industries | Key capital-intensive industries |
| Large firms in the private sector | Strongly promoted | Strongly promoted | Discouraged | Not promoted |
| FDI | Strongly discouraged | Strongly discouraged | Discouraged | Strongly promoted |
| R&D | Private-sector led | Private-sector led | Government-led | Government-led |
| Centralization in policy-making | Strong | Very strong | Very strong | Strong |

Source: Chang (2006)

For example, Singapore continues to promote FDI inflows, but this is not the case for Korea. Traditionally, Korea has been an exports-oriented economy with relatively little emphasis on FDI. The Korean government often discouraged FDI inflows through various regulatory measures, and its main purpose was to control foreign reserves in hand. It was after the Financial Crisis that Korea started to actively promote inward FDI.

Therefore, which is most appropriate mainly depends on the economic pre-conditions of an economy and on global economic environments that the country faces. At the same time, however, looking at the experiences of other countries that succeeded in achieving diversification

could be useful for understanding the policy mechanism for industrial diversification and extracting some lessons from it.

## 3.1. Understanding the Initial Conditions

### *Colonial Legacies and the Korean War (1910-1953)*

In a historical context, Korea and Azerbaijan share a certain degree of similarities, especially for the initial conditions of economic development. During the Soviet era, Azerbaijan specialized in petrochemical products, oil-drilling equipment, and processed foods, mainly serving for the Soviet Union market.

Severance from the Soviet Bloc after independence in 1991 left Azerbaijan with the loss of their major export markets and with excessive capacity for these major exporting industries. Combined with expansionary monetary and fiscal policies by the government, this incurred tremendous economic problems, such as hyperinflation. Invasion of Armenia into Nagorno-Karabakh area further aggravated the situation.

**Table 4-7 | Historical Context: Korea vs. Azerbaijan**

| | Korea | Azerbaijan |
|---|---|---|
| Colonial period | *1910-1945*<br>- Specialization in primary goods and raw materials for the trade with Japan<br>- Industries mostly owned by the Japanese | *1922-1991*<br>- Specialization in petrochemical products, oil-drilling equipment, and processed foods serving for the Soviet Union market |
| Rehabilitation period | *1945-1960*<br>- Colonial legacies and economic turmoil<br>- Korean War<br>- Import-substitution strategy | *1991-1996*<br>- Soviet legacies and economic turmoil<br>- Armenian Invasion into Nagorno-Karabakh |
| Economic take-off period | *1960-1980*<br>- Export-oriented strategy<br>- Heavy and Chemical Industry Drive (1973-80) | *1997-present*<br>- Completing its post-Soviet transition into a major oil-based economy<br>- Industrial diversification |
| Stabilization period | *1980-present*<br>- R&D-oriented industrial strategy<br>- Economic liberalization | |

Similar to Azerbaijan, during the colonial period for 1910-1945, Korea served as a production base of rice and primary goods for the Japanese market. Even though emphasis was shifted into production of military goods later, this was still not directly related to the traditional sectors of the Korean economy.

After the independence, the loss of the Japanese market as well as the separation of South and North Koreas caused massive economic turmoil and stagnation. Since Japan had accounted for most of the industrial ownership and technological manpower, there existed huge shortage of technological manpower and intermediate goods for industries after independence. And then the Korean War (1950-1953) broke out, which resulted in a mass destruction of industrial facilities and sudden inflows of refugees from the North. Estimated physical war damage amounted to 85% of GNP for 1953.

### *Postwar Rehabilitation (1953-1960)*

After the Korean War, the main policy objectives for the government were, first, reconstruction of industrial facilities and, second, economic stabilization against postwar inflation. The eminent problem surrounding economic reconstruction at the time was lack of domestic capital. Thus, Korea was highly dependent on foreign aid from the U.S. and international organizations. With economic and political instability with domestic shortage of consumption goods, the foreign aid was not properly used for rehabilitation. Almost two-thirds of Korean imports were financed by foreign aid during this period, but those imports were mostly-needed consumption goods.

In such circumstances, the Korean government tried to keep the official exchange rate at an artificially high level, in order to maximize foreign aid receipts in dollar term. At the same time, the government ended up with adopting import-substitution strategy to resolve the shortage of consumption goods. Consequently, quite a restrictive trade regime existed, with quite prohibitively high tariffs, quota restrictions and prior approval for imports. It turned out that little economic growth was gained in the import substitution era.

## 3.2. Policies during the Miracle Years (1960-1973)

### *Shift towards the Export-based Industrialization Strategy*

Facing disappointing economic growth, the Korean government abandoned the import-substitution strategy in the early 1960s. The government realized that such a strategy was not appropriate for Korea, due to the small domestic market and its factor endowment with its scarce capital and raw materials. To make things worse, the U.S. announced that they would

reduce development aid to Korea. These all led Korea to adopt the export-based industrialization strategy. Exports began to be recognized as a main conduit of foreign exchange receipts, which in turn could be used for intermediate goods for domestic production and exports.

Two major policies were implemented for reducing the existing bias toward import-competing industries and promoting exports; the first one is to unify exchange rate systems with periodic devaluation and the second is to introduce export incentives as well as partial liberalization of import licensing.

The exchange rate reform in the mid-1960s took two steps. First, the government devalued the Korean currency (Won) by 100 percent and underwent periodic devaluation thereafter. This ensured cost competitiveness for the Korean exporters in the international market. In addition, the Korean government offered compensation to exporters for periodic currency overvaluation through financial and fiscal incentives. Second, the government also switched to a unitary, but managed, exchange rate system and maintained stable real exchange rates throughout the industrial drive.

At the same time, the Korean administration abolished the ad hoc-based export promotion measures and, instead, announced comprehensive measures for export promotion. As Ahn and Kim(1997) explain, there were two key systems for managing the incentives for export promotion. One was free access to imported intermediates inputs used for export production.[10] For example, exporters were entitled to automatic import rights and to easy custom clearance (“Export-Import Link System”). Furthermore, exporters were not just entitled to import needed inputs for producing for export, but they were allowed to import an additional amount (“Wastage Allowance”). Given that the value of imports was still very high, these amounts increased the profitability of exports. The other important policy measure was automatic access to bank loans for financing capital needed for exports, often with preferential interest rates.

One distinct feature of the Korean incentive systems for export promotion is that there was no incentive targeting for specific industries or firms and continuing system re-evaluation by the government. As depicted by Ahn and Kim(1997),

> “Unlike most developing countries, access to basic incentives in Korea was automatic for all production and commercial transactions related to exports. Furthermore, the export bureaucracy functioned efficiently enough to ensure that the incentives and the systems ensuring access to them could be adjusted thorough continuing evaluation by the government in response to the changing environment at home and abroad.”

10. To prevent abuses of export incentives documentation of the completed exports and input-coefficient certificates were required from exporters.

“One important point in providing automatic access (to bank loans) was that it helped export activity without discriminating large conglomerates and small firms. The system was able to minimize the case-by-case directions of bank managers or tax officials and save time. In the light of its underdeveloped money and financial markets and the predominance of credit rationing, Korea’s export financing system made a significant contribution to assuring neutral status for its manufactured exports. “

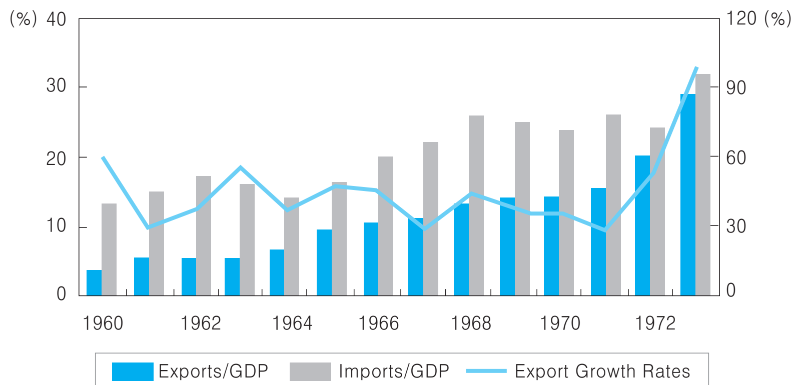
Further, Krueger(1997) argues that a hallmark of Korean economic policy after the early 1960s was consistency. She notices that, even when the government made significant policy mistakes and decided to reverse them, officials were mindful of their roles in having induced private firms to undertake in appropriate activities, and adjusted policies relatively slowly.

Other than the aforementioned exchange rate reform and preparing comprehensive measures for export promotion, the Korean government also made special emphasis on the expansion of infrastructure, including electric power plants, transport and communication facilities, which was much needed for export promotion and industrial developments. These policies greatly contributed to remove major bottlenecks for all exporting activities.

### *Economic Performance during the Miracle Years*

Figure 4-10 contains export growth rates and changes in the trade ratio in GDP of Korea for the periods for 1960-73. The annual growth rate was, on average, 45 percent during this period. Consequently, the share of exports relative to GDP increased from 3 percent in 1960 to 29 per cent in 1973, while the import share grew from 13 percent in 1960 to 32 percent in 1973.

**Figure 4-10 |** The Trends of Exports and Imports (1960-1973)



Meanwhile, this increase in exports was accompanied by a rapid change in export composition, especially from primary products to manufactured ones. As shown in Table 4-8, the top 10 exporting products in 1961 are all primary goods, such as iron ore, tungsten, raw silk, anthracite, and so on. On the other hand, in 1975, the major Korean exports are textiles, electronics, steel products and footwear. In terms of export destinations, the export markets concentrated in two countries, the U.S. and Japan, in the early 1960s, but they were diversified considerably to all around the world.

The rapid expansion of exports also contributed to an acceleration in the growth of value added in manufacturing, thereby enabling miraculous economic growth. In fact, the GDP growth of Korea was the highest in the world during the period.

**Table 4-8 | The Changes in Top 10 Exporting Products (1961-1975)**

| | 1961 | | 1975 | |
|---|---|---|---|---|
| | Exports | Share in Total Exports | Exports | Share in Total Exports |
| 1 | Iron ore | 13.0% | Textiles | 36.2% |
| 2 | Tungsten | 12.6% | Electronics | 8.9% |
| 3 | Raw Silk | 6.7% | Steel Products | 4.6% |
| 4 | Anthracite | 5.8% | Plywood | 4.1% |
| 5 | Squid | 5.5% | Footwear | 3.8% |
| 6 | Other Fish | 4.5% | Deep-sea Fish | 3.6% |
| 7 | Graphite | 4.2% | Ships | 2.7% |
| 8 | Plywood | 3.3% | Metal Products | 2.4% |
| 9 | Grain | 3.3% | Petroleum | 1.9% |
| 10 | Animal Fur | 3.0% | Synthetic Resin | 1.7% |

## 3.3. Heavy and Chemical Industry Drive (1973-1980)

### *Targeting Specific Industries and/or Firms?*

As aforementioned, one important characteristic of export promotion policies in the Korean miracle years was that the government did not target any specific industries and/or firms in providing incentives for export promotion. Uniform incentives contributed to increase exportable production, and left to individual producers the decision which industry or products were most promising. The situation was drastically changed and significant deviation from the export-oriented policies of the 1960s occurred when the government initiated “Heavy and

Chemical Industry (HCI) Plan" in 1973.

There were several motives for shifting into the HCI drive(Krueger, 1996). First, the intensified concerns were raised regarding Korea's capacity to defend itself, notably from North Korea. The United States withdrew one third of its troops in Korea in 1971. This action was understood as a step towards complete withdrawal of ground forces. In such circumstances, the government decided to increase self-defense capacity, which in turn required capacity in HCI industries. The second motive was the growing need to escape from chronic current account deficit.

Third, and most importantly, policymakers believed that Korea was ready to shift away from labor-intensive industries to capital-intensive HCI industries. This belief was reinforced by fear that rising wage levels would lead to weaken cost competitiveness in labor-intensive industries via-a-via Southeast Asian countries.

The HCI plan contained specific projects for the following industries, even with the target-shares in total industrial production; machinery (22.8 percent), chemicals (22.8 percent) steel (22.7 percent), electronics (12.7 percent), shipbuilding (8.0 percent) and non-ferrous metals (3.6 percent). The government started to provide various support targeting these industries. Furthermore, HCI projects were provided with relatively high rates of protection from imports. The effective protection for HCIs reached at 43.2 % in 1978, compared to 3.6% for other manufacturing.

### *Considerable Waste of Resources in the HCI Drive*

A few projects of HCI Plan, however, were proven to be immediately successful, but many of them were heavily loss-creating. The estimated return from the HCI drive was well below that of the more traditional industries. Krueger(1997) argues that the fundamental flaw of the HCI drive was its shift away from reliance upon reasonably uniform incentives to enable the private sector to decide whether projects made sense, to identifying projects by policymakers themselves.

Due to excessive HCI promotion policies, the capacity utilization of the HCI declined substantially in the late 1970s and early 1980s, leading to the real GDP growth rate dropping to a negative value in 1980. As a result, by the mid-1980s, the government virtually abandoned the HCI drive and thus the specific targeting had shifted toward reliance upon uniform incentives for all industries. The number of industries to receive preferential treatment was significantly reduced, and the types of preferential treatment were also cut back.

## 3.4. Key Factors for the Korean Miracle: Institutions

As discussed above, the 'post-WTO' global context that Azerbaijan is currently facing is quite different from the one that Korea experienced. Many promotional measures taken by the Korean government during the rapid economic growth period, cannot be used by Azerbaijan right now.

In this respect, this section will not discuss much about export promotion measures that Korea adopted. Later in this paper, we will get back to this question when we discuss industrial policies under the WTO era. Main lessons form the Korean experience on which we'd like to focus here is rather for institutional systems, helping to effectively implement development strategy in Korea during the early stage of economic development.

### *Institutions and Growth: Bureaucracy*

Ma(2007) argues that, during the early stage of economic development, it is necessary for developing countries to establish institutions supporting industrial policies. In particular, recent history has proven that one of the most important prerequisites for successful economic development is an effective administrative support system with a coherent economic bureaucracy.

In the Korean case, a highly capable, coherent economic bureaucracy, closely connected to, but still independent of, the business community, was one of the key factors for its economic miracle. It does not mean that such system was already built even before the economic development. In fact, modern Korean bureaucracy constructed through intense struggles for reform and endless experimentation over the course of the Post-Second World War period. Until the 1950s, ineffective bureaucracy prevailed and policy instruments were often used for political purposes. Furthermore, bureaucratic staffing itself had been an important form of patronage.

Major organizational reform was undertaken in the 1960s, including the centralized recruitment and selection; improving objective recruiting system, installing performance rating system, installing a performance rating system, adapting a new training system, and finally, improving pay system and installing a position classification system(Cheng et al., 1998). Such reform substantially contributed to rationalize the system of personnel administration and move towards a more meritocratic system.

Another important institutional factor for the rapid economic development of Korea is policy consistency maintained throughout the entire period. Policy consistency significantly reduced uncertainty around business environments and thus contributed to the implementation of long-

term business investments by the private sector. Furthermore, as aforementioned, even when the government made significant policy mistakes and decided to reverse them, officials were mindful of their role in having induced private firms to undertake in appropriate activities, and adjusted policies relatively slowly.

### *Economic Planning Board (EPB)*

Corruption is one of the common phenomena that developing countries face at the early stages of economic development. In particular, bureaucrats are often exposed to vested interests. When it comes down to the long-term economic planning, the problems are even worse, because bureaucratic decision determines the long-term welfare of the citizens as a whole. Therefore, it is very important to design and establish an effective planning body, which is independent from vested interests. In the Korean case, this was the Economic Planning Board (EPB).

The EPB was established in 1961 as a central body of economic development planning. The EPB consisted of the Budget Bureau (which had been initially under the Ministry of Finance), the Statistics and Research Bureau (from the Ministry of Home Affairs) and the Planning Coordination Offices (from the Ministry of Reconstruction). The EPB was given an unusual level of intra-bureaucratic independence and control over the various policy instruments, including foreign exchange, money supply, trade policy, and the budget. Its minister was given the title of Deputy Prime Minister, the 3rd man in government after the President and Prime Minister.[11]

One effective device surrounding the Korean system is the separation of planning function and implementation function. The EPB was mainly responsible for economic planning and overall macroeconomic management, while other ministries were still responsible for implementing policy instruments. This separation helped to reduce opportunities of direct contacts between bureaucrats and interest groups and, consequently, prevent policymakers at the EPB from being exposed to vested interests.

On the other hand, budgeting function within the EPB made its economic planning effectively implemented in other ministries. From its initiation, the EPB had a powerful say over other ministries through the budget. They had the authority to designate and assign the budget to specific projects for which other ministries prepared the budget implications.

11. For example, the Minister of Finance was effectively subordinated to the EPB and the Central Bank was to the Ministry of Finance.

### *The Role of the President*

The President's continuous commitment and full support for export promotion strategy was another crucial factor for the Korean economic success. The President established the EPB and guaranteed intra-bureaucratic independence and autonomy. More importantly, the President continuously monitored the economic situation and policy implementations. The President presided over monthly 'economic situation room' meetings with ministers, political leaders including those from opposition parties, and the leaders of the private sector, to monitor and view economic situations. He seldom missed the meetings over several years. In addition, the President also presided over monthly 'export situation room' meetings with high-ranking government officials and the leaders of the private sector since 1965. He reviewed export performance and removed bottlenecks based on suggestions from the private sector at the meetings.

Finally, it is interesting to note that the President maintained a dual system of bureaucracy. As depicted in Cheng et al.(1998),

> "... Park (the President) continued to rely on, and seek support from, the military. No military personnel held any positions in the Ministry of Finance under Park Chung Hee, but one out of sixteen transportation ministries, nine out of thirteen ministries of home affairs and six out of fifteen construction ministries were held by military personnel. In effect, Chung-hee (the President) created a bifurcated bureaucracy, in which domestic 'service' ministries, such as construction, were staffed with clientelistic appointments, allowed to be relatively inefficient, and served to satisfy domestic patronage requirements."

## 4. Industrial Policies under the WTO Era

Over the last several decades, the world economic environment has been drastically changed. Now, regional and multilateral trade liberalization agreements have become an important part of the international economic system. In particular, the multilateral trade agreements, agreed upon by WTO members, have created new disciplines. The WTO rules have constrained the flexibility of member, and more or less, of non-member States, in the choice of instruments that may be used to pursue industrial policy objectives (See Box 2).

In the following, we briefly summarize international disciplines related to international trade and discuss which policy measures are still allowed under the WTO rules. It is important to carefully investigate international environments and rules, such as the WTO Subsidies Code, in order to achieve industrial diversification without having conflicts with other countries. This

will help to identify what to do' and 'what to avoid' lists for industrial diversification through export promotion.

**Box 2. Two Tales on the Same Coin(Caprio and Amsden, 2004)**

*CASE 1: Brazil, 1960*

The government imposed local content requirements on domestically produced automobiles in order to build up the domestic parts manufacturing sector. Content requirements were accompanied by incentives such as subsidies and preferential access to foreign exchange. This led to an efficient and technologically advanced set of parts suppliers in the country (Shapiro, 1994)

*CASE 2: Indonesia, 1996*

The government imposed local content requirements on domestically produced automobiles as part of the Indonesian national car project in 1993. By 1996, the measure was sniffed out by the EC and a dispute panel was requested. By 1998, the government had eliminated all elements of the requirements that did not comply with WTO obligations.

## 4.1. Trade Policy under the WTO era

The Agreement on Subsidies and Countervailing Measures (hereafter SCM) contains disciplines on the use of subsidies and countervailing measures to offset injury caused by subsidized imports. The SCM defines subsidy as ① a financial contribution[12] ② made by government or any public body[13] within the territory of a WTO member ③ that confer a benefit.

SCM only applies to "specific" subsidies that are targeted at specific firm(s)/sector(s) and thus distort the allocation of resources within an economy. Assuming that a measure is a subsidy within the meaning of the SCM Agreement, it nevertheless is not subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries.

12. Financial contribution includes grants, loans, equity infusions, loan guarantees, fiscal incentives and the provision of goods and services.
13. This covers any public body within the territory of a member, sub-national governments, public bodies and state-owned companies.

The agreement defines two categories of subsidies: "Prohibited" and "actionable."[14] The prohibited category comprises of two major components, export subsidies and local content subsidies for the use of domestic in preference to imported inputs. They are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries' trade. If the WTO dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures.

Actionable subsidies are all those "specific" subsidies that are not directly related to trade but have an effect on export prices. When subsidies belong to actionable category, then the complaining country has to show that the subsidy has an adverse effect on its interests. Otherwise, the subsidy is permitted. The agreement defines three types of damage they can cause. One, country's subsidies can hurt a domestic industry in an importing country. Secondly, they can hurt rival exporters from another country when the two compete in third markets. Thirdly domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country's domestic market. Once this has been proved, the subsidy must be removed or changed to conform to WTO regulations.

The implications of the SCM for industrial policy are considerable. However, it should be noted that, under the SCM, the followings are not defined as subsidies(Tussie and Lengyel, 2004); temporary admission (duty free entry of goods or parts for subsequent export) and drawbacks or tariff reimbursement for imported inputs used in the production of exports. These measures are legitimate and were also heavily used by the Korean government since the Miracle Years.

Export insurances complying with the OECD Arrangement on Export Credits are also not prohibited. In the case of Korea, the Korea Export Insurance Corporation (KEIC) was established in 1992 as the exclusive provider of export insurance. Since the establishment, the utilization ratio of export insurance rapidly increased. Now, Korea has become one of the heaviest users of the export insurance system. It is also expected to be an important export promotion measure(Ma, 2007).

Furthermore, since the SCM applies subsidies that are specific and are proven to have effect on trade, there are various types of subsidies that can still be implemented; for example, those for the provision of physical and social infrastructure; subsidies resulting from low energy taxes

14. It originally contained a third category: non-actionable subsidies. This category existed for five years, ending on 31 December 1999, and was not extended. The agreement applies to agricultural goods as well as industrial products, except when the subsidies are exempt under the Agriculture Agreement's "peace clause," due to expire at the end of 2003.

that benefit all enterprises; subsidies earmarked for specific enterprises according to their size or similar criteria; pre- and post-shipment credit at interest rates equivalent to international ones, etc. Tussie and Lengyel(2004) recently claim that old-style subsidies are often restricted, but there is still maneuvering room to apply them creatively as well as think forward to devise alternative policy initiatives.

## 4.2. FDI Policy under the WTO Era

In recent years, the world has witnessed a remarkable proliferation of foreign direct investments across borders, largely spurred by the accelerated liberalization trend of national FDI policies and the expansion of global production network. Between 1980-2005, worldwide FDI outflows have grown about fourteen-and-a half-fold, while trade flows and GDP have increased by around 5.3 and 4.1 times, respectively.

As borders are becoming ever more meaningless in economic terms, foreign direct investments are emerging as a major channel for boosting economic growth. The attitude towards inward FDI has changed considerably over the last couple of decades. Most countries have liberalized their policies to attract all kinds of investment from multinational enterprises.

While FDI flows to the developing world increased significantly over the several decades, other forms of capital flows have remained fairly stagnant. In fact, FDI is a least volatile form of foreign capital flows, compared to other capital flows such as portfolio investment. This is due to the fact that FDI involves high sunk costs and hence, it is likely to be an irreversible investment in the short run.

The overall number and range of incentives offered to FDI firms, as well as the number of countries that offer incentives, have steadily increased since the mid-1980s. In Tables Annex 2-Annex 4, various incentives for FDI, fiscal, financial and others, are presented(UNCTAD, 1995).

In fact, most direct and indirect FDI incentives come within the definition of subsidies in the SCM. However, there exist some grey areas, since the SCM is for subsidies affecting trade in goods and thus, may not be easily applied to FDI incentives. UNCTAD(2003) divides FDI incentives into the following three categories; the first one is "red-light measures," explicitly prohibited by the WTO because of their distorting effect on trade. As shown in Table 4-9, they include local content requirements, trade balancing requirements and export controls, etc.

The second is "yellow-light measures," explicitly prohibited, conditioned or discouraged by interregional, regional or bilateral agreements. They rang from requirements on domestic

participation to export performance, technology transfer and so on. Finally, the third type is "green-light measures," and is not subject to controls through any multilateral or bilateral investment agreements.

**Table 4-9 | Three Categories of FDI Policy Measures**

| Category | Measures |
|---|---|
| Red-light measures | • Local content requirements<br>• Trade-balancing requirement<br>• Foreign exchange restrictions related to foreign exchange inflows attributable to an enterprise<br>• Export controls |
| Yellow-light measures | • Requirements to establish a joint venture with domestic participations<br>• Requirement for a minimum level of domestic equity participation<br>• Requirements to locate headquarters for a specific region<br>• Employment performance requirements<br>• Export performance requirements<br>• Restrictions on sales of goods or services in the territory where they are produced or provided<br>• Requirements to supply goods produced or services provided to a specific region exclusively from a given territory<br>• Requirements to act as the sole supplier of goods produced or services provided<br>• Requirements to transfer technology, production processes or other proprietary knowledge<br>• Research and development requirements<br>• Measures contrary to the principle of fair and equitable treatment |
| Green-light measures | All other measures |

Source: UNCTAD (2003)

# 5. Policy Suggestions

## 5.1. Guidelines for Export Promotion

At this point and time, it is not clear yet which non-oil products have comparative advantage in the world market and/or have great potential for export expansion in the future. There should be further concrete and extensive research on this issue. Given observations discussed in this paper so far, however, we can suggest the following.

As discussed above, Azerbaijan is currently facing the lack of cost competitiveness, infrastructural weakness as well as technology/marketing gaps compared to advanced countries. Azerbaijan is hardly able to, and it will become more difficult to compete on price in labor-intensive exports to the world market in the near future, mainly due to the recent rise of average wage levels.

Therefore, we recommend the following: At least for the short and medium term, Central Asian (and former CIS) markets and some of the neighboring countries such as Turkey and Iran should be used as a test bed for the exports of non-oil products. The most promising sectors seem to be food and agro-processing. In these markets, not only is Azerbaijan already showing a certain degree of comparative advantage, but Azerbaijan is also showing greater complementary relationships with local demand. These markets are rapidly growing and thus have great potential for import demands, thanks to the recent high levels of oil/commodity prices.

But in what ways could Azerbaijan improve competitiveness of its non-oil products in these markets and, ultimately, in the world market? Attracting Foreign Direct Investment into the non-oil sectors should be an excellent policy option. FDI offers advanced technology and market skills to Azerbaijan, which are the most needed elements to obtain comparative advantage in the neighboring markets.

Export Processing Zones (EPZs) could be a viable and effective option for FDI attraction and economic diversification. EPZs serve as enclaves where obstacles to business development in the rest of the country can be bypassed. That is, they could be islands of good institutions and infrastructure with a certain degree of fiscal and financial incentives to foreign or domestic firms (clusters).

This should also be followed by various efforts in removing institutional bottlenecks for exports and providing export promotion measures to the private sector, especially for small

exporters. For example, a bias against imports of intermediate goods for export production should be removed by applying duty free exemption and/or duty drawbacks for non-oil exports, which are allowed under the WTO rules. Recall that this was also an important policy measure that Korea took during the Miracle Years. According to Navaretti(2003), duty free exemptions are only available for the oil sector under production sharing agreements in Azerbaijan. It also needs further improvement in achieving transparency of customs process.

Sound macro-management favorable to exporters is necessary to reduce uncertainty around the business environment. Especially, keeping exchange rate flexibility, but preventing too much of appreciation is also needed to improve cost competitiveness of the non-oil sector. In addition, to maintain inflation rates low, a prudent medium-term fiscal strategy should be prepared soon. Obviously, it should be designed to be consistent with the long-term fiscal sustainability.

Re-organizing the bureaucratic system could be an option for effectively planning and implementing export-based industrial diversification strategies. For example, like the EPB in Korea, creating an entity, which is responsible for economic development plan but is not vulnerable to vested interests, could be considered.

Meanwhile, Azerbaijan should also make an effort to develop the non-oil sectors for long-run sustainability. Most needed is the establishment of sound infrastructure, especially for improving transport system and constructing new export routes. Taking into account that Azerbaijan is a landlocked country, regional and international cooperation should be strengthened, in the areas such as the normalization of trade relation with neighboring countries, the conformity of technical standards, etc.

## 5.2. Guidelines for FDI Policies

Generally, there are two policy approaches to attract FDI(Oman 2000). The first one is the aggressive use of fiscal and financial incentives, such as lowering taxes or offering subsidies to FDI firms. Indeed, higher tax rates on foreign corporations have a negative effect on FDI: According to Price Waterhouse(2007), one per cent point increase in the tax rate, in general, decreases the FDI stock by about four per cent points.

The basic motive for providing various incentives to foreign investors is to bridge the gap between the private and social returns, thus promoting larger inflows of FDI. As Blomstrom & Kokko(2003) argue, however, when governments compete to attract FDI, there is a tendency to overbid and the subsidies may very well surpass the level of the spillover benefits, with welfare losses as a result. This problem may be particularly severe if the incentives discriminating against local firms and cause losses of local market shares and employment.

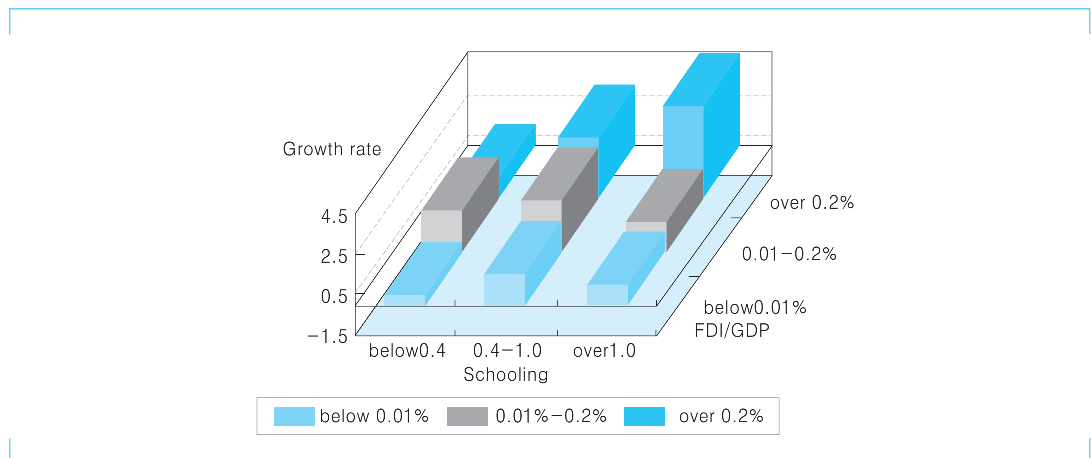
The second is the so-called “beauty contest” approach, by improving the quality of national institutions, educating the labor force and developing infrastructure, macroeconomic stability, etc. Good institutions not only reduce the cost of doing business, but also substantially increase the predictability and credibility of the policy.

Kinoshita and Campos(2006) recently investigated the main determinants of foreign direct investments into 25 transition economies (the CEEB and the CIS) for the periods of 1990-98. They find that foreign investors in the region are not necessarily attracted to a large domestic market size. On the other hand, reform, the estimation results indicate that policy and institutional quality are important determinants of the FDI location. Capital controls on FDI such as approval requirements and restrictions on profit remittance abroad, deter FDI flows. They also find that, while there exists a greater persistence in a pattern of FDI in the CEEB than in the CIS, the resource abundance and adequate infrastructure matter more for the CIS than the CEEB.

Based on these observations, we can conclude that the most important factors to attract FDI into Azerbaijan are institutional improvement, including the presence of relevant infrastructure and human capital, predictable and non-discriminatory regulatory environment and stable macro-economic environment. If Azerbaijan fails to meet these prerequisites, it may be counter-productive to offer various investment incentives to foreign investors.

Furthermore, FDI contribution to the recipient country’s growth also depends on these institutional factors. For example, as shown in Figure 4-11, FDI tends to be complementary to local skilled labor in enhancing economic growth. Moderately priced skilled labor is particularly important for export-oriented investments. According to Blomstrom & Kokko

**Figure 4-11 | FDI and Human Capital**




Note: The sample consists of 69 countries in the world.
Source: Borensztein, Gregorio and Lee (1998)

(2003), one percent point increase in the population above 25 years of age with some post-secondary education results in about a 3 percent increase in FDI

Institutional arrangements, such as Free Trade Agreements (hereafter FTA) and Bilateral Investment Treaties (hereafter BITs) also raise credibility on the consistency of government policies, which helps to attract FDI. In fact, FTA is more effective than unilateral liberalization in raising credibility on the consistency of government policies, which help to attract FDI. According to Yeyati et al.,(2002), a membership in an FTA with a FDI source nearly doubles the bilateral stocks of FDI. And, as for FDI gains due to FTA, less benefits go to countries that are relatively less developed, and closed to international trade.

Bevan and Estrin(2004) find that integration with the EU is important for FDI in transition economies. EU announcements about accession prospects alone increase FDI inflows to countries that are evaluated positively. Countries that have implemented transition policies successfully are promised relatively speedy EU membership, which further accelerates FDI.

Similarly, BITs also contribute to FDI inflows. BITs are an agreement establishing the terms and conditions for private investment by nationals and companies of one state in the state of the other. Foreign investors are often skeptical toward the quality of the domestic institutions and the enforceability of the law in developing countries. In this regard, BITs guarantee certain standards of treatment that can be enforced via binding investor-to-state dispute settlement outside the domestic juridical system. A higher number of BITs increases the FDI that flows to a developing country(Neumayer and Spess, 2005).[15]

## 6. Concluding Remarks

As a resource-based economy, Azerbaijan needs a balance between the oil and non-oil sectors for long-term sustainability. This section briefly examines the current economic conditions of Azerbaijan and provides a number of guidelines for export-based industrial diversification strategies.

Before concluding this section, there are two important things that we would like to add. First of all, industrial development is a continuing process, not just a single event. Periodic

15. Similarly, Buthe and Milner (2005) find that developing countries that belong to the WTO and participate in more FTAs or BITs experience greater FDI inflows.

policy re-evaluation and revisions are necessary to achieve successful industrial development. Krueger(1997) suggests that continuing reforms have been a hallmark of the Korean economic policy, as growth has increased the costs of existing controls and restrictive measures. This would be equally applicable for Azerbaijan. At each stage of economic development, Azerbaijan will face different kinds of obstacles and challenges. Successful industrial diversification can be realized through intense struggles for reform with much of errors and trials.

Generally speaking, there is no resource curse, but institutional curses do exists! What is detrimental to growth is not the dependence on natural resources per se, but rather the inefficient ownership structures and unproductive usage of financial resources. Many resource-based economies in Latin America failed to seize growth opportunities, due to waste of windfall gains to unproductive investment projects through import-substitution strategies. On the other hand, as the examples of Canada, Australia and the Scandinavian countries, diversifying a resource-based economy is quite plausible, given the right institutions and policies.

## Annex 1 Degree of Export Specialization

| HS code | Industry | RCA | Lafay | Commodity Complementarity Index | | | |
|---|---|---|---|---|---|---|---|
| | | | | CIS | Russia | EU | U.S. |
| 27 | Mineral fuels, oils, distillation products, etc | 5.8 | 209 | 0.89 | 0.93 | 0.98 | 1.16 |
| 28 | Inorganic chemicals, precious metal compound, isotopes | 3.6 | 5 | 0.16 | 2.04 | 0.64 | 0.80 |
| 39 | Plastics and articles thereof | 0.5 | 0 | 0.96 | 0.73 | 0.94 | 0.72 |
| 08 | Edible fruit, nuts, peel of citrus fruit, melons | 3.5 | 4 | 0.84 | 0.75 | 0.96 | 0.61 |
| 89 | Ships, boats and Other floating structures | 1.5 | -18 | 2.54 | 1.05 | 0.48 | 0.07 |
| 76 | Aluminum and articles thereof | 1.0 | 2 | 0.28 | 0.20 | 1.09 | 0.74 |
| 15 | Animal, vegetable fats and oils, cleavage products, etc | 2.7 | 1 | 1.13 | 1.12 | 0.72 | 0.48 |
| 52 | Cotton | 1.6 | 2 | 1.02 | 3.15 | 0.45 | 0.13 |
| 73 | Articles of iron or steel | 0.4 | -21 | 1.42 | 1.43 | 0.73 | 0.85 |
| 07 | Edible vegetables and certain roots and tubers | 1.6 | 1 | 1.50 | 1.27 | 1.05 | 0.94 |

Notes: An index of revealed comparative advantage that takes account of both exports and imports and is more suitable for a country with intra-industry trade. Positive values of the Lafay index indicate the existence of comparative advantages in a given product when both exports and imports are considered; the larger the value the higher the degree of specialization. See Lafay (1992) for more detail. The figures for RCA and Lafay indices are from ITC database. The figures for Commodity Complementarity index are the author's estimates.

Sources: UN COMTRADE and ITC database

## Annex 2 Fiscal Incentives for FDI by type (UNCTAD, 1995)

| Type | Policy Measures |
|---|---|
| Profit-based | Reduction of the standard income-tax rate; tax holiday; allowing losses incurred during the holiday period to be written off against profits earned later (or earlier). |
| Investment-based | Accelerated depreciation; investment and reinvestment allowance. |
| Labor-based | Reductions in social security contributions; deductions from taxable earnings based on the number of employees or on other labor-related expenditure. |
| Sales-based | Income-tax reductions based on total sales. |
| Value-added-based | Income-tax reductions or credits based on the net local content of outputs; granting income-tax credits based on net value earned. |
| Other expenses-based | Income-tax reductions based on, for example, expenditures relating to marketing and promotional activities. |
| Import-based | Exemption from import duties on capital goods, equipment or law materials, parts and inputs related to the production process |
| Export-based | a) Output-related (e.g., exemptions from export duties; preferential tax treatment of income from exports; income-tax reduction for special foreign-exchange-earning activities or for manufactured exports; tax credits on domestic sales in return for export performance).<br>b) Input-related (e.g., duty drawbacks (tax credits for duties paid on imported materials or supplies); income-tax credits on net local content of exports; deduction of overseas expenditures and capital allowance for export industries). |

## Annex 3 Financial Incentives for FDI by type (UNCTAD, 1995)

| Type | Policy Measures |
|---|---|
| Government aid | A variety of measures (also loosely referred to as direct subsidies of grants) to cover (part of) capital, production or marketing costs in relation to an investment project. |
| Government credit at subsidized rates | Subsidized loans; loan guarantees; guaranteed export credits. |
| Government equity participation | Publicly funded venture capital participating in investments involving high commercial risks. |
| Government insurance at preferential rates | Usually available to cover certain types of risks such as exchange-rate volatility, currency devaluation, or non-commercial risks such as expropriation and political turmoil (this type of insurance is often provided through an international agency). |

## Annex 4 Other Incentives for FDI by type (UNCTAD, 1995)

| Type | Policy Measures |
|---|---|
| Low-cost infrastructure | Include provision, at less-than-commercial prices, of land, buildings, industrial plants, or specific infrastructure such as telecommunications, transportation, electricity and water supply. |
| Low-cost services | Services offered may include assistance in identifying finance; implementing and managing projects; carrying out pre-investment studies; information on markets, availability of raw materials and supply of infrastructure; advice on production processes and marketing techniques; assistance with training and retraining; technical facilities for developing know-how or improving quality control. |
| Market preferences | Preferential government contracts; granting of monopoly rights (e.g., exemption from domestic antitrust regulation, closing the market for further entry); protection from import competition (e.g., through import restrictions). |
| Preferential treatment on foreign exchange | Special exchange rates; special foreign debt-to-equity conversion rate; elimination of exchange risks on foreign loans; concessions of foreign exchange credits for export earnings; special concessions on the repatriation of earnings and capital. |

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